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The Political Impact of Islamic Banking in Jordan

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The Political Impact of Islamic Banking in Jordan

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Dedication

To Nisreen, Areej, Ibtihal and Muadth

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Finally, I want to thank my daughter, Nisreen Malley, who has become a scholar of Islamic finance in her own right and who inspired me to bring this project to completion.

The Political Impact of Islamic Banking in Jordan

Mohammed Mathew Malley, Ph.D.

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Supervisor: Clement Henry

This dissertation examines Islamic banking in Jordan. It is argued that institutions perceived as culturally authentic may play important political roles in a post-colonial society. Islamic banking in particular can both function in a modern, globalized economy and express cultural tradition. It may help to legitimate Jordan's political structures and overcome social and economic bifurcations between traditional and modern sectors of society.

Jordan is a part of a region of the world in which the colonial experience continues to have an enduring legacy. What had previously been a tribal Bedouin society was transformed almost overnight. Its modern banking system transgressed Islamic norms and laws and excluded huge portions of the population who continued to see meaning in the religious values and principles rooted in the social and cultural institutions that had just been trampled upon.

This dissertation looks into how Islamic banks that interact in a global economy while remaining true to culturally authentic beliefs and practices can begin to close the gaps between state practice and popular beliefs. The strongest opposition to the monarchy in Jordan has come from political Islamists who feed upon popular discontent and

alienation caused by the practices and actions of a ruling elite that does not share the same cultural values as the majority of the population. Much of what the Islamists espouse, while culturally authentic, is removed from the political, financial, and economic realities of the modern era. Islamic banking thus has the potential to play a mediating role between a modernizing elite and this Islamist backlash.

This dissertation will test the extent to which cultural authenticity matters by observing how Islamic banks in Jordan have been able to tap into a latent demand for alternative financial practices and how the Islamic financial movement relates to Islamist political movements. Although Islamic banking has not achieved its full potential, the dissertation presents strong evidence of its capacity to bridge divisions between state and society.

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INTRODUCTION: The Political Impact of Islamic Banking in Jordan

Islamic banks and financial institutions constitute an increasingly important segment of the financial sector of a number of Muslim countries. In November of 2010 there was approximately $895 billion deposited in Islamic banks[1] while total assets of the Islamic financial system throughout the world were estimated to be around 1.3 trillion dollars and both the banks and other Islamic financial instruments are expected to continue growing at an annual rate of 10 - 20%. The size and growth of these Islamic banks and financial institutions has important ramifications for the societies, economies and politics of the regions in which they are located.

Different kinds of financial systems have been shown to have different political effects, especially in terms of the relationships between state and society in general and state and business in particular. Financial innovations often lead to changes in markets, the means of commerce, and the economic life of societies. Economies exist in a cultural context and therefore financial innovations also impact wider aspects of culture and society. Financial power also translates more directly into political power and therefore

[1] The $895 Billion figure comes from Joseph DiVanna and Brian Caplen, *The Banker: Top 500 Islamic Financial Institutions*, (The Banker, Nov. 2, 2010) an annual survey of Islamic financial institutions which has been published by *The Banker* magazine since 2007. For an early estimate of the size of the Islamic financial sector see Ibrahim Warde, *Islamic Finance in the Global Economy*, (Edinburgh Univ. Press, 2000), 1 where he estimated that the sector had increased more than forty-fold from 1982 to 2000 to exceed $200 billion. From 2000 to 2010, the sector has grown an additional six-fold and the $1.3 trillion figure comes from the second edition of Warde's book published in 2010. The $895 Billion that *The Banker* accounts for includes some but not all of the Islamic finance assets in conventional banks with Islamic windows and thus should be seen as a very conservative figure. Furthermore, in addition to Islamic banks, there are growing Islamic capital market activities involving Islamically-compliant mutual funds and the *sukuk* market (which is the closest thing there is to an Islamic bond).

through both direct and indirect means, finance affects the state, society, power relations and elite formations. The growth in many Muslim countries of an alternative Islamic financial system existing side-by-side with conventional banking systems is having profound political effects.

Islamic banks have allowed for what is seen as authentic financial practices in a region of the world where all banks had previously been seen as representing foreign influences. This has led large segments of the populations of a number of countries, especially from the lower classes, to enter into financial systems that they had previously excluded themselves from. It has in turn helped in the strengthening of new conservative business elites not tied to colonial or outside powers in a region of the world where most large business interests have traditionally had strong foreign ties.

The rise of Islamic banks has also provided governments with a means to increase their legitimacy through the permission and support of what is seen as a non-threatening form of Islamic expression in a region where most governments lack legitimacy largely because they are perceived as not being Islamic enough. Such banks have also given new importance to the Ulama (Islamic religious scholars), a class whose power had waned in the past century. After decades of being shunted aside to deal only with family law matters, the Ulama have once again taken center stage in the very important arena of economic and financial affairs as their advice is sought concerning what constitutes truly Islamic financial practices.

The rise of Islamic banks has also given new legitimacy to the idea that Islam is applicable to all areas of life, an idea that can have profound political implications, especially since it is the central idea of the Islamist political movements that constitute the strongest political opposition in most Muslim countries. While the success of Islamic financial institutions provides legitimacy to the ideas espoused by the Islamic political movements, these same financial institutions also represent an alternative channel of Islamic work, a channel that is seen by many as more practical than the work undertaken by Islamist movements and a channel that often has strong interests in both maintaining good relations with the state authorities and preserving state stability, interests that are not always shared by Islamist political movements. How Islamist movements and Islamic financial institutions deal with their common and conflicting interests has important ramifications on both the activities and ideas of the movements and financial institutions themselves as well as on larger political issues, such as the state's relations with Islamic movements and the development of democratic institutions in countries where Islamic movements constitute the strongest political opposition.

In many ways the alternative financial practices represented in Islamic Banking represent a civil society countermovement occurring in a region of the world where the colonial experience resulted in the rise of new internal elites while former elites were stripped of the institutional frameworks that had formerly sustained them. The dis-unified and fragmented elite structures that have arisen in most Middle Eastern societies in the wake of the colonial experience largely pits traditional elites against newer commercial and political elites whose sources of authority and wealth are often closely linked with the former colonial powers. The cultural alienation felt by the more traditional elites has often manifested itself in Islamist political opposition movements – which have at times taken on radical, even violent, overtones. Islamic banking can potentially provide the older, more traditional elites with an institutional framework that can enable them to compete with the newer elites on a different playing field – one of finance and business and perhaps even competitive politics.

The rapid rise of Islamic banking has led to a massive literature on Islamic economics. This literature deals extensively with the technical jurisprudential matters concerning non-interest banking but almost totally ignores the important political effects that such banking is having on the politics and societies of the Muslim world. This dissertation will analyze the political side of Islamic banking through a case study analysis of Jordan. The dissertation will have three main focuses.

First, it will analyze the general social and economic effects of Islamic banking and financial practices on Jordanian society. By providing financial services to important societal segments that had earlier been excluded from all forms of organized finance, Islamic financial institutions are bringing about important social changes in Jordan.

The dissertation will also closely look into the relationship between Islamic banking and political Islam in Jordan and how the two affect and influence each other. While there are few direct ties between Islamist political actors and Islamic financial actors, the two share many indirect ties. Analyzing these ties and looking in detail at the economic program of the Islamist political actors in Jordan will provide important information about a side of Islamism that has not been studied in detail in the past.

Finally, the dissertation will analyze the confluence of these two societal-based aspects and discuss what the existence of Islamic banking means for the Jordanian state and its future political structure. Islamic banking is still a young and dynamic phenomenon that is forcing Muslim states to pass creative financial legislation that deals with Islamic issues at a time when globalization is providing such countries with new financial challenges and when those countries are facing strong opposition by Islamists. This confluence of issues brings up some interesting dichotomies. While political Islamists often rail against the neo-liberal economic reforms associated with globalization, Islamic financiers have strong interests in globalization reforms. The manner by which Muslim regimes deal with these conflicting pressures will have important long-term effects on their political legitimacy and stability as well as on the overall political and economic development of their countries.

Particularly in Jordan, Islamic financiers seem well-positioned to play an important intermediary role between Jordan's globalizing secular business elite and the country's traditional conservative business elite as well as between the angry urban Islamist political opposition and the Jordanian Monarchy. To successfully manage such an intermediary role will result in a more unified elite structure in the country in a way that facilitates important political and economic reform.

By looking into the political side of Islamic banking, the dissertation will thus fill important gaps in the study of the politics and economics of the Muslim world and will be of interest to Middle Eastern specialists and those studying Islamic Movements as well as those interested in developmental economics and finance and how finance affects politics in developing countries. It will also prove useful to the growing number of scholars interested in the economic and financial side of Islamic banking by adding an important new dimension to their field of study.

CHAPTER SUMMARY

The first chapter of the dissertation will undertake a review of the literature in three important fields. First, the review will cover the theoretical work that deals with the power of capital and the influence financial institutions have on politics and political institutions. The contributions a further understanding of the political side of Islamic capital can make to this theoretical literature will be pointed out. Second, the literature on Islamic banking will be discussed with a view to showing where that literature can be expanded and enriched by bringing in a political dimension. Finally, the political economic literature on Jordan as well as the work on Islam in Jordan will be reviewed so as to show where a further understanding of the political role of Islamic banks can add important insights into broader political and economic concerns in an important Middle Eastern country.

The second and third chapters will provide important historical and political background to the field of study. The second chapter will provide a historical overview of Islamic banks, discussing their origin, their growth, and the current problems and challenges they are facing. The chapter will include data on the number, size, and location of Islamic banks in the world, on the kinds of financial instruments Islamic banks use and on the disputes taking place in the field of Islamic banking. The third chapter will provide a historical, political, and economic overview of Jordan. Political decision-making and the role of Islam and Islamic Movements in Jordan will be stressed as will the economic situation in the country. The economic problems Jordan is facing, the system of finance in Jordan, and specific information about Jordanian banks including the role and place of Islamic banking in Jordan, will be discussed.

The fourth and fifth chapters will deal with the political effects of Islamic banking in Jordan. The fourth chapter will look into the general effects Islamic banking has had on Jordanian society. It will analyze the extent to which Islamic banking has affected class relations in Jordan and allowed for the emergence of new elites in the country. The fifth chapter will deal with the Islamic movement in Jordan. It will analyze the economic agenda of Jordan's Islamists, look into the effects Islamic banking has had on the actions and ideas of Jordan's Islamic Movement, and discuss the relations and potential future relations of Islamist political and Islamic banking leaders in Jordan.

The sixth chapter will use the data gathered by the Jordanian case to make a theoretical argument about the political role of Islamic banking. The importance of Islamic banking and finance in understanding larger political concerns will be stressed as will the role that Islamic banking can play in healing some of the longstanding wounds left over from the colonial era by bringing about changes in the structure of Jordanian elite formations that are more conducive to economic and political development.

CHAPTER ONE: LITERATURE REVIEW

FINANCE AND POLITICS: FROM IBN KHALDUN TO MONTESQUIEU

Political scientists have long recognized the influence of economics and commerce on political systems. In the 14th Century Ibn Khaldoun asserted that dynasties flourish when there is a healthy level of commercial activity and noted that a sign of dynastic decline was evident whenever governments began overtaxing their citizens, thus making commerce less able to succeed.[2] He also made the observation that governments themselves that tried to engage in commerce and agriculture with the intent of increasing state revenues would lead to the inevitable "destruction of civilization" and "disintegration of the dynasty" as such activities would make it impossible for private merchants to undertake successful commerce.[3] Ibn Khaldun also noted that in the 14th Century milieu in which he was writing, the accumulation of too much capital could be a dangerous thing for any individual as it would inevitably lead government officials to become avaricious and ultimately expropriate wealth in a manner that would "spell harm and hardship to its owners."[4]

Ibn Khaldun's cyclical theory of the rise and fall of dynasties was thus closely linked to the manner by which commerce was able to flourish and was then subsequently checked by the authorities. The lack of a financial system that could protect capital from

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[2] Ibn Khaldun, *The Muqaddimah*, trans. Franz Rosenthal, (Princeton University Press, Princeton, 1967), 231.
[3] Ibid., pgs 232-234.
[4] Ibid., pgs 280-281.

the hands of the authorities ultimately meant that dynasties could not last more than a few generations.[5]

In *The Spirit of the Laws* (1748), a book that laid the theoretical foundations for the separation of powers, Montesquieu found that financial systems were changing the political nature of some European nations. Montesquieu asserted that certain financial instruments had a profound impact on limiting the arbitrary rule of leaders, forcing them to accept more democratic rule.[6] In Part I of *The Spirit of the Laws*, Montesquieu notes that an exception existed to the classical idea that democracies could only survive when wealth is not too abundant or too unequally distributed. Montesquieu's exception was for what he called democracies based on "commerce."

In Book XXI of the treatise, it becomes clear that Montesquieu's conception of commerce involved the existence of important financial instruments. In a chapter entitled "How Commerce Broke through the Barbarism of Europe," Montesquieu explains how commerce had long been hampered in Europe by church prohibitions on interest-taking until Jewish money-lenders, who had previously been persecuted for their money-lending activities, invented "letters of exchange." Montesquieu argues that the invention of this simple financial concept enabled commercial activities to take place without violence as wealthy traders could quickly, easily, and without hindrance send invisible wealth anywhere in the world. Montesquieu notes that since the invention of letters of exchange,

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[5] In the Muqaddimah, Ibn Khaldun states that "as a rule no dynasty lasts beyond the life span of three generations." See page 136.

[6] For a discussion of Montesquieu's *The Spirit of the Laws* see Albert Hirschman, The Passions and the Interests, (Princeton University Press, 1977). For an English translation of the French *Esprit des lois* see www.constitution.org/cm/sol.htm.

rulers have been less able to arbitrarily confiscate the wealth of their citizens and have subsequently been compelled to govern with greater wisdom. Letters of exchange solved the dilemma that Ibn Khaldun had earlier described and thus – if Ibn Khaldun was correct - could have a profound impact on not only the spread of commerce but also on political stability.

In Book XXII of the same treatise, Montesquieu further explains how another simple financial concept further weakened rulers when he discussed the ability of bankers to undertake foreign exchange transactions. Prior to such transactions, rulers could arbitrarily debase their coinage by using smaller percentages of gold and silver and larger percentages of copper or other metals and then, through the use of such debased currencies, extract more from their subjects with less compensation. Montesquieu notes that: "It is evident that such violent proceedings could not take place in the present age; a prince might deceive himself, but he could deceive nobody else. Foreign exchange operations have taught bankers to draw a comparison between all the money in the world, and to establish its just value."[7]

In a work whose main concern was discovering ways to check the abuse of unlimited powers in the hands of arbitrary rulers, Montesquieu found that the development of simple banking institutions had historically played a crucial role in establishing structural impediments to the abuse of power. The importance placed on banking and commerce in bringing about more liberty and checking oppressive

[7] See Book XXII, Chapter 13; "Proceedings with Respect to Money in the Time of the Emperors" of Spirit of the Laws with English translation at www.constitution.org/cm/sol.htm

tendencies was picked up and further developed by other classical political economists and historical sociologists such as Adam Smith, John Millar, and Sir James Steuart.[8] All of them argued that the ability of bankers to hide and quickly move wealth placed restraints on rulers and thus had a profound impact on bringing about more liberty in society. With the invention of simple banking procedures a financial system could be derived that made it no longer rational for tyrants to engage in the kinds of barbaric actions that they had employed in both Europe as well as the North African and Middle Eastern countries discussed by Ibn Khaldun.

Karl Marx also recognized the power of bankers as holders of capital though he came to different conclusions than those arrived at by Montesquieu and the classical political economists.[9] Marx concluded that the holders of capital were endowed with a power that no political institutions could overcome. Banks were a means of concentrating capital and thus could serve to solidify the power of those who own the productive wealth of society.

POLITICS INFLUENCING FINANCE AND DEVELOPMENT

Despite the classical recognition of the importance of financial institutions on political systems, finance and banking have not always been seen as independent variables in the political science or even political economy literature. Goldsmith is

[8] Hirschman, pgs 81 – 101.

[9] Karl Marx and Friedrick Engels, *Capital Vol. III.* See especially "Part V: Division of Profit into Interest and Profit of Enterprise. Interest Bearing Capital." An online version can be found at: http://www.marxists.org/archive/marx/works/1894-c3/index.htm

representative of the early political economy literature that discussed the connections between finance and development.[10] While Goldsmith finds clear parallels between economic development and the 18th and 19th Century establishment of the modern financial system characterized by the existence of several kinds of financial institutions and financial instruments, he does not look at the political side of the equation. Political repression of the financial system is not discussed nor is the manner by which developments in finance and financial institutions have affected political development.

Later political economists recognized the important linkages between politics, economics and finance but still largely ignored delving into the possibility that financial systems could affect political systems. Haggard and Kaufman's work is representative of most of the political economy literature of the 1980s and 1990s that looked at the extent to which political decisions affected the success or failure of economic adjustment and reform.[11] While some of the essays in the Haggard and Kaufman volume (most notably that of Barbara Stallings) argue about the power of international financial institutions over the policy process of indebted nations, there is no real analysis of how the local banking and financial structure affects the political decision-making process. Haggard and Kaufman also note that the economic changes that took place in the 1980s in Asia, Africa and Latin America had important effects on the establishment and consolidation of democratic governance. They however explain differences in such effects on the institutional arrangements for managing political conflict and not on financial

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[10] Raymond Goldsmith, *Financial Structure and Development*, (Yale University Press, New Haven, 1969)
[11] Stephen Haggard and Robert Kaufman, *The Politics of Economic Adjustment*, (Princeton University Press, Princeton, 1992).

institutional arrangements. Again, banking and the financial system is not discussed as an independent variable.

STRUCTURAL POWER OF FINANCE

Marxist writers continued discussing what Przeworski and Wallerstein described as the theory of the "structural dependence of the state on capital."[12] Most Marxist writers however spent more time describing capital in terms of its owners with very little discussion on the financial system through which the power of capital is channeled. Banks are often seen as mere intermediaries with little real power.

Winters makes a powerful argument for the power of capital over the political decision-making process in his study of Indonesia.[13] He shows how radical policy changes took place in Indonesia from 1965 to the mid-1980s based on the extent to which capital was in the hands of private investors rather than the state. As long as investors had the ability to supply the capital needed to stabilize Indonesia's economic system in the 1960s and early 1970s, they held tremendous political power over the state, which was forced to establish a set of economic policies favorable to the desires of the investors. During the oil boom from the mid-1970s to the mid-1980s, the Indonesian state itself became awash in its own state-controlled financial resources and was thus free to change its economic policies, making them less responsive to the private owners of capital.

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[12] Adam Przeworski and Michael Wallerstein, "Structural Dependence of the State on Capital," *The American Political Science Review*, Vol. 82, No. 1. (March, 1988), pp. 11-29.

[13] Jeffrey Winters, Power in Motion: *Capital Mobility and the Indonesian State*, (Cornell University Press, Ithaca, 1996).

When oil prices fell dramatically in the mid-1980s, the Indonesian state again became structurally dependent on the private investors and policies shifted back to becoming favorable to their interests.

Winters shows how the huge policy swings that took place in Indonesia cannot be explained by changes in leadership or ideological orientation or on military, party, or regional politics and power or on changes in the institutional structure of the state, demographic pressures, or international politics. The changes can only be explained by the structural power that capital controllers have over the economic policy decision-making process. Winters shows how the structural power of capital occurs as a natural result of those controlling capital satisfying their interests and does not require conscious coordination among investors. The imperative for investment to sustain a social system provides the holders of capital with a deep and structural power to decide whether or where to invest.

The financial system is described as a mediator in the process of capital exercising power. While Winters notes that the form of mediation that the capital takes is less important than the fact that it is capital itself, he does recognize that the financial system existing in a country or society makes an important difference in both making a jurisdiction more or less vulnerable to the structural pressures capital controllers can create and in making decision makers more or less likely to respond to the demands of investors. Private and portfolio capital is described as the most powerful forms of capital while capital that is channeled through commercial banks is seen as much weaker since banks do not have the capacity to adequately monitor how the funds they provide are used by policymakers.

Winters' finding that the holders of capital can wield influence over the policy-making process is also found in both the literature that deals with the relationship between business and the state and in the interest group literature. In much of this literature, institutions are looked at more closely and banks are seen as an institution with political ties that can make them more influential – even if structurally weaker – than the holders of portfolio capital. While Winters notes that the power of capital acting in its self-interest is powerful enough to wield influence even in the absence of conscious coordination among the holders of finance, others have described instances in which actual coordination does take place.

Maxfield describes an alliance of private bankers in Mexico that in coalition with large-scale traders and industrialists and public sector monetary authorities have historically been able to shape economic policy-making in the country.[14] Maxfield argues that the power of the Bankers Alliance waxes and wanes based on a number of factors that are similar to factors described in the interest group literature. In addition to the argument that the characteristics of similar alliances in other countries can explain differences in economic policy patterns in a comparative perspective, Maxfield argues that the alliances and the policies they shape can explain the differences in the impact of international financial integration on different countries.

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[14] Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics*, (Cornell University Press, Ithaca, 1990).

BANKS AND FINANCIAL SYSTEMS AS AN INDEPENDENT VARIABLE

Alexander Gershenkron takes the argument about the power of banks a step further, seeing them as an independent variable explaining not only economic policy-making but actual regime type. In 1962, Gershenkron explained the establishment and long tenure of a dictatorial regime in Russia as having emanated from the lack of a strong banking system.[15] He argued that the lack of robust banking systems in some “relatively backward economies” led governments to take the place of banks in accumulating capital and directing it toward investment in heavy industry. Whereas industrial banking was able to develop in countries like France and Germany (both of which were relatively backward in relation to England in the 19th Century), no such banking system developed in Russia and Gershenkron points out that that lack of industrial banking can explain the long period under which the Russians were led by a dictatorial Soviet government which could only undertake the kind of capital accumulation necessary for industrialization through coercive taxation policies. Gershenkron extends his argument from Russia to other non-European countries whose lack of strong banking systems is a determining factor in the establishment of dictatorial regimes.

Zysman expanded upon Gerschenkron’s argument about how the existence or lack of a strong banking system could shape the political structure of a country by arguing that different financial systems have a profound impact upon the capacity of the political authorities to intervene in the industrial economy of a nation and is thus an

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[15] Alexander Gershenkron, *Economic Backwardness in Historical Perspective*, (Harvard University Press, Cambridge, 1962).

important determinant of a country's political structure.[16] While Gershenkron argued that the lack of a robust banking system could delay democratic development, Zysman looked only at different democratic industrialized nations and found that differences within the structure of the financial systems in those countries constitute an important variable in how their political structures differ. Zysman asserts that there are three distinct types of financial systems among the democratic industrialized nations, typified by the Anglo-American system with strong capital markets, the heavily statist credit-based French financial model, and the German credit-based system dominated by financial institutions rather than the state. He then shows how the different financial systems put different constraints on a government's ability to intervene in the economy and have an important effect on the role that business interests can play in the politics of a country.

The Anglo-American financial system prevents state authorities from intervening in the economy and creates institutional circumstances that favor business-led adjustment. The French model requires the state to play an active role in orienting the economy and influencing the position of particular sectors. The German model establishes conditions that warrant the establishment of strong business cartels in which political decisions concerning the economy are the result of a bargaining process involving finance, labor, government, and industry. Zysman thus takes Gershenkron's argument a step further by showing that not only the strength or weakness of banking but

[16] John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change*, (Cornell University Press, Ithaca, New York, 1983)

actually the differing kinds of banking have important consequences on the political structure of countries.

Zysman thus expanded upon the idea of Montesquieu, the classical Economists, the Marxists and Gershenkron that finance influenced politics by showing that even relatively slight differences in the manner, organization and makeup of financial institutions could profoundly impact the political decision-making process in a country. Contrary to the globalization narrative that market expansion will inevitably lead to financial standardization along the lines of the Washington consensus,[17] Zysman also shows that even within the capitalist West there exist profound differences in how financial systems are organized and that those differences are based on historical, cultural, and social norms of the countries in which they originated.

The idea that historical, cultural and social norms of a society are important to economic life echoes the anthropological theories of Karl Polanyi.[18] Polanyi argues that economies are embedded in both economic and non-economic social institutions, such as religion and government, and that any analysis of an economy that ignores these institutions will be flawed. Polanyi further argues that when radical economic transformations take place they hold the potential to disembed economies from their social bases leading to widespread cultural alienation that can result in political turmoil.

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[17] For a concise explanation of the different principles making up the Washington Consensus see John Williamson, "In Search of a Manual for Technopols," in John Williamson ed., The Political Economy of Policy Reform, (Institute for International Economics, Washington DC, 1994).

[18] Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, (Boston: Beacon, 1944). Also see Gregory Baum, *Karl Polanyi on Ethics and Economics*, (Quebec, McGill Queen's University Press, 1996).

Henry expounded upon Zysman's institutional argument by applying it to developing countries while also bringing into it the findings of Winters and others about the deep structural power of capital. He shows how different financial systems influenced political structures in different ways not only in the industrialized Western democratic nations but also in the Middle East, Africa, East Asia and Latin America. Henry explained how variants of the Anglo-American, French, and German financial models can be seen in the developing nations and that the specific model adopted by developing countries has a profound impact on the democratization process.[19] Henry argues that the power of financial institutions to invest or withhold financing of projects of its choice can be substantial enough to push for governmental accountability thus underscoring the important role that banks and financial systems play in the political structure and development of countries.

In his book, *The Mediterranean Debt Crescent*, Henry posits a strong theoretical argument about the potential power of commercial banks because of their roles both as a mediator between rulers and businesses and between local rulers and the international financial system.[20] Drawing from the insights of both Zysman and Winters, Henry describes the conditions under which a commercial banking system can foster sufficient business autonomy and organization to transform a political regime making it more democratic.

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[19] Clement Henry, "The Financial Arms of Industrial and Political Activity," paper presented at the International Conference on the Role of the Business Sector in Economic and Political Change, (Tunis, August 30 – Sept. 2, 1998).

[20] Clement Henry, *The Mediterranean Debt Crescent: Money and Power in Algeria, Egypt, Morocco, Tunisia and Turkey*, (University Press of Florida, Gainesville, 1996).

He notes that the economy must be sufficiently developed to have generated a powerful array of business enterprises and that those enterprises must be indebted to the commercial banking system. He further points out that the banks must be organized into an oligopoly with the finance capital concentrated in the hands of a small number of commercial banks capable of engaging in collective action and containing a critical nucleus who have enough market power to discipline weaker banks. Henry believes that these conditions coupled with pressure from international financial institutions for more financial liberalization will allow for the rise of strong business conglomerates that will have the structural power and interests to challenge state authorities and force them toward greater accountability.

Taking this into account brings up the question of how an increasingly Islamized financial system – or how dual Islamic and conventional financial systems existing side-by-side – will affect the political makeup and decision-making process in Muslim countries. Has the Islamic prohibition on certain conventional banking practices – similar to earlier Christian prohibitions discussed by Montesquieu - made financial institutions in the Muslim world too weak to affect political processes in favor of democratization and will the growth of new Islamic financial institutions empower the financial sector in a way that can influence political change? Will a strong Islamic banking sector put the structural power of capital into the hands of Islamists that have political and ideological interests that are different from the purely financial interests that Winters and Maxfield described as existing in the conventional financial systems; and if so, how will this play out in terms of political and social change in Muslim societies? Are there structural aspects of Islamic finance that will either facilitate or impede political reform in the ways that different financial systems led to different political outcomes described by Zysman?

My theoretical goal in this dissertation is to look into all of these issues to come to a better understanding of the impact the growth of Islamic financial institutions is having on the political and social landscape of the Muslim world. In light of the literature positing the kind of impact that capital and financial institutions can have on political structures it becomes relevant to look into how the estimated 1 trillion dollars that are already invested in Islamic financial institutions and the continued rapid growth of the Islamic financial sector is impacting upon the political institutions and norms of the countries where Islamic finance is important.

ISLAMIC BANKING AND FINANCE

While there is an extensive literature on Islamic banking and finance, very little in that literature actually touches upon the political aspects of these increasingly important institutions. Islamic legal scholars currently debate, modify, and pass new judgments concerning financial issues more than they do in perhaps any other area of Islamic law.[21] Much of the literature on Islamic banking deals with either these legalistic issues or with the technicalities of the Islamic financial and banking instruments and the means of making them work within the global financial order.

[21] Another growing field of new Fiqh interpretations concerns medical practices.

The most comprehensive treatment of the Islamic legal framework through which Islamic banks operate was undertaken by Vogel and Hayes.[22] In their work, Vogel and Hayes explain the religious textual basis of rulings concerning Islamic finance and detail what is and what is not Islamically permissible in terms of financial transactions. They explain what is meant by the forbidden practices of usury or interest (riba), gambling or pure speculation (maysir) and uncertain risk (gharar). The terms have highly technical meanings and thus modern transactions require Islamic legal scholars to distinguish between them and perfectly legitimate profit-sharing and risk-taking transactions. Vogel and Hayes then explain in detail some of the permitted contracts and conclude with an explanation of the debates concerning possible innovations in Islamic financial products. The book is representative of the vast literature on the subject of Islamic banking in that it deals with these complex subjects from a purely technical and legalistic framework and avoids any discussion of the political ramifications of Islamic banking in the countries in which it is taking place.

ISLAMIC BANKING'S SOCIAL AND ECONOMIC IMPACT

Chapra is representative of another genre of literature on Islamic banking that deals with the social and even political ramifications of Islamic banking but from a purely theoretical viewpoint that tries to define the societal benefits that Islamic banking will

[22] Frank E. Vogel and Samuel L. Hayes, III, *Islamic Law and Finance: Religion, Risk, and Return* (Kluwer Law International, The Hague, 1998).

bring about in modern countries.[23] Works of this sort are written largely by devoted Muslims who defend Islamic legal rulings by discussing their assumed positive societal impact but rarely provide real life examples of how Islamic banking has actually affected a society or country.

One of the biggest critics of this type of work and of the whole project of Islamic banking is Timur Kuran.[24] Kuran argues that the practical applications of Islamic economics – including in addition to Islamic banking such practices as Zakat (religiously required alms) collection and distribution - have had no positive effects on efficiency, growth, or poverty reduction in the Muslim world. He further argues that the Islamic financial movement has sprung up as a means of resisting globalization and Western capitalism and has no real economic or even religious basis. He traces the genesis of Islamic economic thought to prominent Islamist ideologues such as Abul-Ala Mawdudi (founder of the Jamaa Islamia Islamic movement in Pakistan), Sayyid Qutb (prominent member of the Muslim Brotherhood in Egypt) and Muhammad Baqir al-Sadr (prominent Shiite Islamist in Iraq) in the early 20th Century. He asserts that their notion of an economics discipline that is distinctly Islamic is a very modern concept that cannot be found in the classical sources of Islam. Kuran asserts that this new discipline had much more to do with fulfilling the Islamist political agenda of its founders than with truly discovering Islamically acceptable means of finance in the modern world.

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23 M. Umer Chapra, *Islam and the Economic Challenge*, (The Islamic Foundation, Leicester, 1992).
24 Timur Kuran, *Islam and Mammon: The Economic Predicaments of Islamism*, (Princeton University Press, Princeton, 2005).

Kuran's critique provides an empirical analysis that will in the future force those writing in the genre of Chapra to look for more comparative and empirical studies to buttress their theoretical claims. However, Kuran's analysis of the genesis of Islamic banking in the past forty years is simplistic. While Islamists such as Mawdudi were the first to write about Islamic economics, the field has taken on a life of its own and its rapid growth is a reality that cannot be dismissed as a mere attempt by Islamists to protect themselves from Western domination.

Islamic economics is a modern discipline but that is because it is only in modern times that the global financial system has reached so extensively into the Muslim world. In fact, the establishment of Islamic banking and other financial institutions in the manner that it has come about can be seen more as an attempt to find Islamically acceptable ways to participate in the international financial system than to isolate themselves from it.

Kuran's critique that Islamic finance is not having any positive effect on efficiency, growth, or poverty reduction is echoed by El-Gamal.[25] Rather than conclude that the practice of Islamic finance is an attempt by Islamists to isolate themselves from the West, El-Gamal shows that it is more an attempt to provide Islamic legitimacy for what is essentially the same thing as conventional financial practices with added transaction costs in the form of jurist and lawyer fees. El-Gamal is critical of the industry because of its obsession with using pre-modern contract forms and even adopting their classical names and then using jurists, economists, and lawyers to tweak those contracts

[25] Mahmoud El-Gamal, *Islamic Finance: Law, Economics, and Practice*, (Cambridge University Press, New York, 2006).

in ways that make them appear as close as possible to conventional financial practices without ever delving deeper into the original objectives of the Islamic laws concerning which the pre-modern contracts were first formulated.

El-Gamal finds that those original objectives are actually being violated as the Islamic financial industry chases form over substance. Looking closely into the classical Islamic jurisprudence, El-Gamal finds that the original objectives involved enhancing fairness and economic efficiency. He asserts that with advances in modern communication and legal structures these objectives are currently being served in conventional financial systems and the use of pre-modern contract structures in the current financial milieu is having the opposite effect, leading to losses in efficiency and potentially unfair practices. El-Gamal calls for moving Islamic finance away from finding avenues for putting an Islamic face on conventional practices and more toward a reflective look at the original objectives of the Islamic laws and applying them in such things as community banking, microfinance and socially responsible investment. El-Gamal's work is inspiring a new genre of literature that is more reflective of Islamic finance and financial practices.[26]

While the critiques of the Islamic banking industry are merited, they were considerably weakened by the 2007-2009 global financial crisis.[27] The crisis focused attention on important differences between Islamic and conventional finance, undermining the idea that the differences were only cosmetic. In the 1990s as El-Gamal

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[26] See for example Maha-Hanaan Balala, *Islamic Finance and Law*, (I.B. Tauris, London, 2010).

[27] Nisreen Malley, "Islamic Banking: An Innovation that Altered the Financial Structure of the Muslim World," *Texas Historian* LXXI, 2010-2011, 18.

rightly points out, regulations that did not allow Islamic banks to undertake leveraged investments were seen as a hindrance to the growth of the industry that Islamic financial jurists and lawyers were trying to work around. After the crisis, however, these restrictions came to be seen by many Islamic jurists as a positive factor that made Islamic banking inherently more stable than conventional banking. Islamic scholars became much more confident about the merit of Islamic restrictions on the role of finance and more critical of attempts to put an Islamic face on conventional practices.[28]

The long-term future trajectory that the still young industry takes cannot be foreseen. However, whether Islamic financial professionals, lawyers and religious jurists become more conservative or they go back to working to find ways to make conventional financial practices Islamically legitimate, large and growing sums of capital will likely continue to flow into Islamic financial institutions. This dissertation aims less at engaging in the debate about what is Islamically permissible and more at looking at the political effects the industry is having on the societies of the Muslim world.

POLITICAL ASPECTS OF ISLAMIC BANKING

Ibrahim Warde and Clement Henry have written more extensively than any others on the political aspects of Islamic banking. Warde undertook a comprehensive study of the historical, political, economic, social, and cultural context in which Islamic banks and other forms of Islamic finance operate.[29] He finds that there is great diversity in all of

[28] See 2010 edition of Warde, *Islamic Finance in the Global Economy* , 89.
[29] Ibid.

these aspects of Islamic finance. He especially points out that it would be misleading to make generalizations about their ties to or impact upon Islamist political movements or governments.

Clement Henry dealt with Islamic banking from a more politically theoretical angle.[30] He discusses the possibility that the introduction of financial pluralism through Islamic banking could establish powerful business coalitions in support of political change. He also notes that the legal and institutional structure needed for successful Islamic banking requires a high degree of transparency and accountability on the part of the bankers. Since interest rates cannot be fixed by Islamic banks but must be tied to the profitability of the investments they make, such banks require an even higher degree of transparency than conventional Western banks. As a result, depositors in Islamic banks demand access to more information and hold bankers to a higher degree of accountability than is the norm in conventional banks, especially in developing countries. Henry argues that the institutional requirements for successful Islamic banking hold the prospect for Islamic banking bringing about the kinds of changes in finance that could ultimately lead countries toward more transparent and accountable political systems.

He further argues that Islamic bankers hold the potential of shifting the political weight within Islamic Movements away from oppositional politics and more toward responsible business elements ready to coexist with the capitalist order. This shift would provide them with strong interests in maintaining the stability of a country's banking

[30] Henry, 1996. See also Clement Henry and Rodney Wilson ed., *The Politics of Islamic Finance*, (Edinburgh University Press, Edinburgh, 2004) for a series of articles on the impact of Islamic Banking on the politics of a number of countries.

system and the autonomy of the private business sector. Henry tested this theory in Egypt of the late 1980s and early 1990s but found that Egypt proved to be an unfair test due to a unique situation in Egypt in which large amounts of ostensibly "Islamic" capital were never incorporated into the Islamic banking system as well as the degeneration of political competition between Islamists and the government into violent armed confrontations.

This dissertation will test Henry's theory in Jordan, looking more deeply into the actual political and social impact that Islamic banking has had on the country. While from the purely financial perspective, as Kuran and El-Gamal show, Islamic financial practices may be less efficient than conventional practices, and the practice of Islamic economics in countries like Sudan, Iran, or Pakistan - where technically it is the only permissible form in the country - has not had any positive impact on growth or poverty reduction, it remains to be seen from the political and sociological perspective what effects the existence of Islamic banking is having on Muslim societies in which significant sections of the population remain distrustful of conventional financial practices.

Are Islamic bankers in Jordan more transparent and accountable than conventional bankers and are the structural aspects of Islamic banking having any impact on the worldview of Islamists? Can evidence be found in Jordan that Islamic finance is leading to positive social change, not so much because of anything inherent to the Islamic practices that make them superior to conventional practices but because they are bringing segments of the population that avoided finance in the past into the country's financial system? While the extensive technical literature on Islamic financial instruments and economics is important, this dissertation will focus on an aspect of Islamic banking that has been less studied but that in the long run - as more reflective discussions on Islamic banking take place - could help frame future discussions of where Islamic finance will be heading.

JORDAN AS A CASE STUDY

For a number of reasons, Jordan is an optimal case for looking at the relations between Islamic movements and Islamic banks, as well as the larger question of what implications the Islamic financial sector has and will have for the political economies of Muslim countries. First, Jordan has a very strong and well-established Islamic movement that has historically been allowed a greater level of political freedom and maneuver than the Islamic movements of most other Arab countries. This relative political freedom has also enabled the Islamic movement of Jordan to have some space in which they can influence the political process. This is especially true since the 1990s during which the Jordanian Parliament was restored and the Islamic Action Front became, by far, the largest political party in the country. In addition, Jordan has a strong Islamic banking sector, with the Jordan Islamic Bank, established in the late 1970s, being one of the pioneers in the field. In the late 1990s, the Arab Bank, one of the largest, strongest, oldest, and most well-respected conventional banks in the Arab world, also opened a new Islamic bank in the country.

Having both a strong Islamic political movement and a strong Islamic financial movement thus makes Jordan an optimal case study for looking at the relations between these two movements. In addition, the nature of the Jordanian economy makes it a good case study. Jordan is a middle-income country that neither suffers extreme poverty nor enjoys the luxury of abundant natural resources. The country's ruling elite has long been economically dependent on the continuation of huge rents in the form of direct monetary aid from the Gulf Arab states and the large remittances that flow into Jordan from expatriate workers. When the price of oil declined in the late 1980s and then Jordan was seen to support the 1991 Iraqi invasion of Kuwait, both these forms of rent were lost, leading to major economic and political crises in the country. These large rents had long distorted the Jordanian economy and their loss forced Jordan to begin tackling some major structural problems. What is especially interesting is that this transformation and these major economic policy decisions took place at the same time that the Islamic movement enjoyed substantial representation in Parliament and thus was able to (or perhaps forced to) participate openly in the economic debates that were taking place in the country.

With the rise in oil prices after the turn of the century (and a concomitant rise in remittances from Jordanians working in the oil-exporting countries) as well as increased foreign aid from the West, Jordan has regained the rents that it historically relied upon. The political and economic crises of the late 1980s and 1990s subsided with the increase in rents and, in the absence of crisis, Jordan has witnessed a political de-liberalization.

The country, however, remains dangerously dependent on outside sources of revenue (and the kind of patronage networks that they have enabled the monarchy to establish).

While taking Warde's caveat into account that the experience of one country cannot be generalized to others, Jordan provides a good case study of a country which has allowed enough political space for both an Islamist political movement and an Islamic financial movement to thrive while at the same time neither is truly co-opted into the government. There has been relatively little Islamist-inspired violence in Jordan; and while the Islamic movement in the country has at times felt repressed by the government, the kind of repression in Jordan has never reached the level of other states in the region. At the same time, the Islamic Movement is considered an opposition movement. Even if the movement has been careful to avoid direct attacks against the monarchy, the movement is clearly critical of many aspects of the kingdom and has been in the forefront of calling for political, social, and economic change.

JORDAN'S POLITICAL ECONOMY

The political liberalization that has taken place in Jordan since the parliamentary elections of 1989 has led to a number of studies about the Jordanian political system and how the Jordanian state has managed its Islamist movement. Rex Brynen in a 1998 book about political liberalization throughout the Arab world notes that Jordan has proceeded along the path of political liberalization "faster (and perhaps farther) than any other country in the Arab World."[31] Brynen discusses at length the factors that have pushed Jordan toward liberalization, including a discussion of the economic factors, as well as the impact the Islamist movement has had on liberalization.

Wiktorowicz has written an in depth study of the relationship between the Jordanian state and various kinds of Islamic expression in Jordan.[32] He notes that the financial crisis the country suffered from in the 1980s was an important catalyst for democratization and political liberalization and explains how in the aftermath of the crisis the state has been able to use its bureaucratic codes and procedures to regulate and manage the scope and content of Islamist groups in the country. It would be interesting to look further into whether the political processes used by the state have also been attempted in the field of Islamic finance.

The potential implications that Islamic finance could have on both political liberalization and economic reform was posited in a survey of the Arab world that discusses the effects of globalization on political liberalization in different Middle Eastern countries. Henry and Springborg note that Jordan is more amenable to accepting economic reform than most other countries in the region.[33] They also find that Islamists in Jordan offer the monarchy useful political cover during the process of structural

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[31] Rex Brynen, "The Politics of Monarchical Liberalism: Jordan," from Bahgat Korany, Rex Brynen, and Paul Noble ed. *Political Liberalization and Democratization in the Arab World: Vol. 2, Comparative Experiences*, (Lynne Rienner Publishers, Boulder, 1998). pg. 71.

[32] Quintan Wiktorowicz, *The Management of Islamic Activism: Salafis, the Muslim Brotherhood, and State Power in Jordan*, (State Power of New York Press, Albany, 2001).

[33] Clement Henry and Robert Springborg, *Globalization and the Politics of Development in the Middle East,* (Cambridge University Press, New York, 2001).

economic reform and note that "it may also not be coincidental" that Jordan is "in the forefront of Arab states hosting Islamic banking."[34]

The authors recognize the potential connections in Jordan between Islamic banking, economic reform, political liberalization, and the relations between the state and the Islamist movement. While noting that not enough research has yet been done to gauge the level to which Jordanian Islamic banks are linked to Islamist politicians, the authors posit that in Jordan it is likely that a variety of Muslim Brothers and other Islamists connected with business and financial circles can provide King Abdullah with cover as he takes what could potentially be unpopular political and economic decisions. The authors assert that: "In Amman and elsewhere, coalitions between Islamic financiers and Islamist political oppositions could be useful safety valves for incumbent regimes. ... Not only can Islamic finance moderate Islamist political oppositions, by giving them stakes in the economic system, but it can also legitimate government efforts to reform their respective economies."[35] The potentially far-reaching implications of Islamic finance on a country like Jordan have however not been fully researched by studies on the Jordanian economy.

Since the late 1990s a number of books have been written about the Jordanian economy and business and investment conditions in Jordan. In a book about the economic challenges in Jordan and the need for market reform, Piro asserts that there is a need to look at the country's domestic political structure to understand what will make

[34] Ibid. pg. 188.
[35] Ibid. pg. 193.

market reform succeed or fail.[36] He discusses the political factors that led to the rise of an interventionist state in Jordan and the political factors that sustain such intervention. While he notes that the Muslim Brotherhood have called for letting the forces of the free market help Jordan cope with its economic problems,[37] he doesn't look in depth at what led to such a political decision by the Brotherhood parliamentarians. Piro also does not discuss the financial system in Jordan – much less the potential role Islamic banking is playing or can play in market reform - at any length.

Like Piro, Carroll makes similar comments about Islamists being generally supportive of economic reform and the private sector though she notes that the lack of personal ties between the Islamist and business communities has led to misunderstandings and tension on some political issues.[38] In a book aiming to discuss how state-business relations characterized by reciprocity and trust can be fostered in the service of development, Carroll declines to mention how governmental support for Islamic banking could potentially play a role in fostering trust between the state and the country's Islamist business elite.

Moore also looks at state-business relations in Jordan and how those relations have affected economic and political reform.[39] Moore however gives more weight to the role played by Islamists in the overall evolution of business-state relations in the

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[36] Timothy Piro, *The Political Economy of Market Reform in Jordan*, (Rowman and Littlefield Publishers, Oxford, 1998).
[37] Ibid., pg. 99.
[38] Katherine Blue Carrol, *Business As Usual? Economic Reform in Jordan*, (Lexington Books, Lanham Maryland, 2003).
[39] Pete Moore, *Doing Business in the Middle East: Politics and Economic Crisis in Jordan and Kuwait*, (Cambridge University Press, Cambridge, 2004).

kingdom. Moore is critical of prevailing social science theories that rely on the assumption that domestic business reactions can be explained by structured incentives. He asserts that there is a need for a more systematic analysis of the historical-institutional legacy of business-state relations and the political context in which businesses are operating.

In looking at business-state relations in Jordan and Kuwait, Moore finds that the outcomes diverge from expectations in that Jordanian business has not been nearly as successful as Kuwaiti business in coordinating with the state despite the fact that Jordan is a less sectorally and rent-dependent state. Moore asserts that such divergences can be explained by looking at political context and most importantly the calculations political elites have to make concerning the relative strength of other social rivals for business privilege and state power, which in the case of both Jordan and Kuwait is political Islam. By bringing political context into the equation of business-state relations, Moore underscores the importance of the Islamist factor in Jordanian political and economic developments. In light of such an analysis, a further study of how Islamic bankers could mediate between the state, business, and the Islamic movement becomes even more pertinent.

In this dissertation, the role Islamic finance has played in Jordan's political liberalization, the Islamic movement in Jordan, and the relationship between Islamism and political liberalization will be looked at in depth. What has the role of Islamic banks been in Jordan and what is their relationship with the political Islamists in the country? Do they serve the role of a safety valve for the regime as Henry and Springborg said they could? Have they played the role of giving Jordanian Islamists a stake in the economic system and thus moderated Islamist opposition to the state, especially in the area of unpopular economic reform legislation? What is the relationship of Islamic bankers in Jordan with the country's business elite and what role have they played in fostering or sabotaging business-state coordination? This dissertation will borrow from Moore's insights into the role of political context in explaining economic change but look more deeply into an area that Moore ignored, namely the role of Islamic banks in the wider context of the political and economic changes taking place in the kingdom.

CHAPTER TWO: HISTORICAL OVERVIEW OF ISLAMIC BANKING

THE MUSLIM WORLD'S FIRST ENCOUNTER WITH CONVENTIONAL FINANCE

Foreign branches of European commercial banks were established in various parts of the Muslim world in the 19th Century.[40] The establishment of the banks was part of a broader phenomenon of increasing European encroachment on Muslim lands and the finance they forwarded was generally geared toward serving the infrastructural and commercial needs of foreign trade.[41] In the second half of the 19th Century, many Muslim governments accumulated huge debts, at unfavorable terms, that in many cases ultimately led to bankruptcy and either precipitated foreign occupation, as in Egypt, or resulted in foreign control over government finance, as in Turkey. The Muslim world's first encounter with modern banking and finance was thus a sordid one and provided much of the impetus for the call by Muslim intellectuals and Islamic activists for the establishment of an alternative system of finance that would not violate Islamic prohibitions on interest-taking.

ISLAMIC LEGAL CODE

The religion of Islam is based on the Qur'an and the sayings and actions of Prophet Muhammad (known as the *Sunnah*). Muslim religious jurists compiled and

[40] The East India Company established a bank in India as early as 1809 and the French began opening branches of French banks in Algeria in 1851. The Banque de Constantinople was established as the first bank of the Ottoman Empire in 1840 during the period of European inspired reform in the Ottoman state. See Bernard Lewis, *The Emergence of Modern Turkey*, (Oxford University Press, London, 1968), 111.

[41] Charles Issawi, *An Economic History of the Middle East and North Africa*, (Columbia University Press, New York, 1982.)

organized all the collected sayings and actions of Prophet Muhammad and then using them along with the Qur'an developed an Islamic legal code known as the *shari'a*. In addition to religious affairs (the correct way to pray, fast etc.) the *shari'a* covers personal matters (to the extent of how to eat, sleep etc.) as well as important social, political, and economic affairs of state and government. While the *shari'a* is not clear on every matter and there are certainly many issues that are open to more than one interpretation, Islamic religious scholars overwhelmingly agree that it is a religious obligation upon all Muslims to follow the *shari'a* in all aspects of their lives.

The most explicit aspect of the *shari'a* that deals with economic affairs is the prohibition on *riba*. The Arabic word *riba*, which is usually translated as interest, occurs in the Qur'an and was mentioned by Prophet Muhammad a number of times. The most explicit Qur'anic verses occur in Chapter 2. In verses 275 and 276 of Chapter 2, the Quran states:

> "Those who take *riba* will not stand except as stands someone who has been driven to insanity by the touch of Satan. That is because they say: 'Trading is like *riba*, whereas God has permitted trading and forbidden *riba*. Those who after receiving the admonition from their Lord stop taking *riba* shall not be punished for the past, their cases are for God to judge, but whoever repeats, they are the dwellers of the Fire – they will abide therein forever. God will destroy *riba* and will give increase for *sadaqaat* (deeds of charity)."

After these general verses, the Qur'anic prohibition on *riba* is continued. In verses 278 and 279, the Quran states: "Oh you who believe, be cognizant of God and give up what remains (due to you) from *riba* if you are really believers. If you do not, then be warned of a war from God and His Messenger, but if you repent, you shall have your capital sums. Deal not unjustly and you shall not be dealt with unjustly."

One of the companions of Prophet Muhammad, Jabeer, reported that: "The Messenger of God – peace be upon him – cursed the one who takes *riba*, the one who pays it, the one who writes a contract in which it is mentioned and the witnesses to such a contract. He said that they are all equal in sin."

In addition to these clear prohibitions against *riba*, the prophet also prohibited *gharar*, or ambiguous sales. The prohibitions against *gharar* are derived from sayings of Prophet Muhammad that forbade such things as the sale of fish in the sea (i.e. selling for a determined price whatever is caught by a fisherman on a particular day), horses still in the wombs, or a crop yield on a certain field before the crop has actually grown. The fact that the prophet prohibited both *riba* and *gharar* was indicative of the fact that both practices were widespread in the society in which he lived. In fact, the prophet's uncle Abbas was a moneylender who had derived substantial wealth from lending on interest and in one of the prophet's famous speeches, he asserted that henceforth all moneylenders must give up the interest owed to them and he said that the money owed to Abbas was the first to be forgiven.

During the prophet's lifetime and for hundreds of years afterwards, the *shari'a* was truly the main source of legislation for commercial and civil matters in Islamic states. Muslim jurists subjected commercial practices to close scrutiny and derived a number of contractual templates that enabled Islamic states to become commercial and trading leaders of the world while not violating the prohibitions against *riba* and *gharar*.

Until today the constitutions of nearly all Muslim majority countries have a clause stipulating that the *shari'a* is the major source of legislation in the country. However, in reality, when most of these countries came under occupation during the colonial era, new legal systems adopted from European models were derived and have remained even after the countries gained formal independence. The *shari'a* continues to be used for family law matters (such as marriage and divorce) but for almost nothing else. The dichotomy between claiming to follow the *shari'a* and actually following European derived legal codes is a lingering source of tension in many Muslim countries and many Muslims see the commercial laws of their countries - in which interest-based banking systems are the predominant and state-supported form of finance - as one of the clearest examples of the state not abiding by Islamic precepts.

19TH CENTURY: DEBT AND THE CRITIQUE OF CONVENTIONAL FINANCE

The Muslim world's first encounter with modern banking and international finance came in the context of 19th Century colonial practices that weakened Muslim countries and tied them into an international financial system in a manner that did not serve their developmental or economic interests. The fact that such financial practices also contradicted fundamental Islamic religious beliefs opened them up to early criticism from Muslim scholars who saw them as clear deviations from the *shari'a*. The critique was most pronounced in Egypt, which was the most economically developed country in the Muslim world in the late 19th and early 20th century and also the center of Islamic learning, being the seat of Al-Azhar, the world's most prestigious Islamic university.

Looking at the historical situation in Egypt helps in understanding the context in which this critique started. Having taken its first foreign loan in 1859, Egypt was in so much debt by 1865 – largely incurred to build the Suez Canal - that it could no longer even pay the interest on its loans.[42] Egypt's financial crisis led to the establishment of the Caisse de la Dette Publique in 1876 which constituted a body of four European commissioners appointed to supervise Egyptian state revenue and expenditure. When the Egyptian ruler, Ismail, refused to abide by some of their demands he was deposed by the British in 1879. Under his successor a nationalist movement that was critical of Egypt having come under European financial control grew in strength and the British army took formal control over Egypt in 1882 with the argument that they were needed to protect British investments in the country. The British occupation of Egypt lasted until 1954.

During the early years of the British occupation, the debate over banking and finance became pronounced. While most of the Muslim scholars from Al-Azhar University continued to argue that interest and banking was forbidden in all their forms, many Egyptian nationalists began arguing that there was a need to establish an Egyptian – as opposed to foreign-owned bank - that would serve the industrial needs of the country. Talaat Harb led the movement calling for the establishment of a national bank that would be financed with Egyptian capital. Harb was very critical of the European banks but noted that Egypt needed a national bank to provide the financing needed for industrialization.

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[42] Afaf Marsot, *A Short History of Modern Egypt*, (Cambridge University Press, New York, 1985), page 68.

Some Muslim scholars, including the well-respected Sheikh Muhammad Abduh, found Harb's arguments about the necessity for a national bank convincing and, looking deeper into how modern financial practices worked, concluded that interest on savings accounts and for investment purposes did not constitute the forbidden *riba.*[43] The scholars who opposed Abduh's interpretation of *riba* were weakened by the fact that they could not forward any alternative financial practice or system that could take the place of modern banking institutions. The support of Abduh and like-minded Muslim scholars was an important factor that enabled Harb to found Bank Misr in 1920. Similar national conventional banks were founded in other Muslim countries at around the same time.

ISLAMIC ECONOMICS

Largely as a reaction against increasing foreign cultural and economic encroachments on Muslim lands and in response to the 1924 abolishment of the Caliphate – the last remaining symbol of Muslim political unity and rule by the *shari'a* - Muslim intellectuals and activists in the early 20th Century began calling for rediscovering Islam as the basis for a new social and political system. The Muslim Brotherhood was founded in Egypt in 1928 with the goal of establishing a truly "Islamic State" that would rule in accordance with Islamic precepts. The Jamaat-e-Islami was founded on the Indian subcontinent in 1941 with the same goals.

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43 Randolph Peters, "Divine Law or Man-Made Law? Egypt and the Application of the Sharia," *Arab Law Quarterly*, Vol. 3, No. 3, 1988, page 234.

As part of the larger call for a return to Islam and away from Western influences, the economic system of the West was heavily criticized and Islamic parties, groups, and intellectuals began calling for the establishment of an Islamic economic system that would be more just than either the prevailing Capitalist or Communist systems. Sayyid Abul A'la Maududi, the founder of the Jamaat-e-Islami coined the term "Islamic economics" in the 1940s and wrote profusely on the evils of interest and theorized that an interest-free economy would be more just.[44] Sayyid Qutb in Egypt and Muhammad Baqir Al-Sadr in Iraq also wrote on the subject of Islamic economics and in the 1940s and 1950s the idea that Islam could provide an alternative economic and financial system to the prevailing systems that had recently been incorporated into the Muslim world from the West became popularized and the promotion of such a system became one of the main planks of Islamic movements that aimed at the comprehensive return to Islamic principles in all walks of life.[45]

These early writers on Islamic economics were either religious scholars or journalists and had no formal training and very little actual understanding or knowledge of economics.[46] They made only casual references to banking in the discussion of wider issues relating to the Islamic economic system as a whole.[47] However, as the idea of an

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[44] Timur Kuran, "Islamic Economics and the Islamic Subeconomy," *The Journal of Economic Perspectives*, Vol. 9, no. 4, (Autumn, 1995), pp. 155-173.

[45] The most prominent books written in this genre were Sayyid Qutb, *al-Adalat al-ijtima'iyah fi l-Islam*, (Social Justice in Islam), first published in 1948 and Muhammad Baqir Al-Sadr's book *Iqtisaduna* (Our Economics) first published in 1961. See Muhammad Siddiqui, *Muslim Economic Thinking: A Survey of Contemporary Literature*, (The Islamic Foundation, Leicester, 1981).

[46] Ibid.

[47] Muhammad Ariff, "Islamic Banking," *Asian-Pacific Economic Literature*, Vol. 2, no. 2, (September 1988), pp. 46-62.

alternative Islamic economics became more popularized, trained economists in the Muslim world began offering theoretical models of banking and finance as a substitute for interest-based banking.

In 1955, Mohammad Uzair developed a model based on classical Islamic laws and commercial contracts that allowed Muslims to invest partnership capital with others who would use the capital in a productive manner.[48] In Uzair's model, the Islamic bank would undertake two such contracts – the first with the depositor and the second with an entrepreneur. Rather than charging an interest-rate to the entrepreneur, the Islamic bank would be entitled to a percentage of the entrepreneur's profits. Rather than giving an interest rate to the depositor, the bank would distribute a percentage of its overall profits to its depositors. While there were many practical difficulties in applying Uzair's model, it laid the framework for a plethora of later studies in which trained economists discussed banking and other financial practices within the confines of Islamic law.

The first modern experiments applying the principles of Islamic finance were undertaken in the 1960s in Egypt and Malaysia. The efforts in Egypt were pioneered by Ahmad El Najjar who established a savings bank in the Egyptian town of Mit Ghamr in 1963.[49] The bank invested in trade and industry, directly or in partnership with others, and shared its profits with depositors. The bank was founded at a time in which Islamists were being severely repressed by the Egyptian state and El Najjar thus undertook his experiment without labeling it Islamic. Despite his attempt to keep the Islamic nature of

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[48] Mohammad Uzair, *An Outline for Interestless Banking* (Raihan Publications, Karachi, 1955) cited by Frank Vogel and Samuel Hayes, *Islamic Law and Finance: Religion, Risk and Return*, (Kluwer Law International, The Hague, 1998), pp. 130-131.
[49] Ariff, 1988, p. 46.

the bank secret, many known Islamists worked at the bank and while the bank closed after five years, the experiment continued to motivate Islamists in Egypt, Jordan and elsewhere.

The Malaysian experiment, Tabung Haji Malaysia, began in 1962 as an investment fund that enabled Malaysians to save the money needed to undertake the Islamically mandated pilgrimage to Mecca.[50] Rather than provide an interest rate on the savings, the fund invested the money and provided depositors with a share of the profit. Similar to a mutual fund account, the Tabung Haji Malaysia was touted as an Islamic alternative to interest-based financial institutions and continues to exist until today making it the oldest Islamic financial institution in modern times. The success of the fund encouraged Muslims throughout the world to work for the adoption of Islamic alternatives to interest-based financial practices.

ISLAMIC BANKS

Islamic banking took a major leap in the mid to late 1970s with the establishment of a number of modern Islamic banks.[51] The first was the Dubai Islamic Bank (1975) followed by the Kuwait Finance House (1977), the Faisal Islamic Bank of Egypt (1977), the Islamic Bank of Sudan (1977), the Jordan Islamic Bank for Finance and Investment (1978), the Bahrain Islamic Bank (1978), and the International Islamic Bank for Investment and Development in Egypt (1980). A number of international Islamic

[50] Mervyn Lewis and Latifa Algaoud, Islamic Banking, (Edward Elgar Publishing, Cheltenham, 2001), 6.
[51] Ibrahim Warde, *Islamic Finance in the Global Economy*, (Edinburgh University Press, Edinburgh, 2000), 75.

investment banks were also established at around the same time including the Islamic Investment Company in Nassau (1977), the Islamic Investment Company of the Gulf in Sharjah (1978), the Shariah Investment Services in Geneva (1980), and the Bahrain Islamic Investment Bank in Manama (1980).

The rapid rise in oil prices after 1973, which led to abundant capital accumulation in the Arabian Gulf countries, was a major impetus to the establishment of the Islamic banks. While by the 1970s, conventional banks had existed in the Muslim world for nearly a century, there were still many Muslims who refused to place their funds in interest-bearing accounts and the Islamic banks were a means of incorporating many of those idle funds into a financial system. King Faisal of Saudi Arabia was also a strong proponent of the establishment of a pan-Islamic Bank and at the 1974 Organization of the Islamic Conference (OIC) summit in Pakistan he led the effort to establish the Islamic Development Bank (IDB), which came into existence in 1975. The IDB was primarily used to facilitate the flow of investment and assistance from the oil-exporting countries to other Muslim nations and as a means of promoting trade and development among the members of the OIC. While at least initially the majority of the bank's profits came from interest bearing deposits with foreign banks, the IDB also engaged in Islamic financing practices with member countries and has over the years been the foremost promoter of studies on Islamic economics and financial practices.[52]

[52] Nicholas Dylan Ray, Arab Islamic Banking and the Renewal of Islamic Law, (Graham and Trotman, London, 1995) p. 6.

Since the establishment of the first Islamic banks in the mid-1970s, the industry has continued growing at a rapid pace. The establishment of new banks has corresponded with the growth of publications and academic studies on the concept of Islamic economics with numerous international conferences being held annually as well as the establishment of specialized research institutions and increasingly university departments that teach and provide degrees in Islamic economics. Concomitantly, there has been a rapid rise in the amount of time Islamic *shari'a* scholars spend debating and writing about the Islamic permissibility and prohibitions of certain economic practices.

Throughout the 1980s the governments of three countries, Pakistan, Iran and Sudan, all of which claimed legitimacy through Islam, declared their intention and worked toward the full Islamization of their economies including prohibiting interest-based banking in their countries. In other Muslim countries, Islamic banks continued proliferating alongside conventional banks with different degrees of governmental assistance and support. Malaysia and Bahrain are marked out as countries in which the governments made deliberate attempts to help their Islamic financial sectors become world leaders in the field and in which Islamic finance became a principal tool in the country's overall developmental policies.[53]

In 1991 the Accounting and Auditing Organization for Islamic Financial Institutions was founded in Bahrain and counted most Islamic banks throughout the world as members working toward establishing agreed-upon standards for Islamic banks

[53] Warde, (2000), pgs. 123-129.

in the areas of accounting, auditing, governance, and *shari'a* compliance.[54] The felt need to establish such standards is an indicator of the increasing international recognition accorded to Islamic banking.

This recognition is also apparent in the fact that the World Bank and the International Monetary Fund published numerous working papers and articles on Islamic banking starting in the mid-1980s. Harvard University became a major center for research on Islamic finance with the establishment of the Harvard Islamic Finance Information Program in 1995. Harvard University has since held annual conferences on Islamic finance and published numerous books and articles on the subject. Large international conventional banks in the United States and Europe began opening Islamic financial windows in the 1990s to cater both to investors from the Muslim world as well as increasingly to the Muslim populations in the Western countries. Muslims living in the United States and in many Western European countries can now purchase homes through American and European banks using Islamic financing methods. The United Kingdom has gone further than any other Western country in accommodating Islamic finance and even changed its tax laws in 2005 and 2006 to provide the same kinds of incentives and advantages to those dealing in Islamic finance as those dealing in conventional financial practices.[55]

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[54] See the webpage for the Accounting and Auditing Organization for Islamic Financial Institutions at: http://www.aaoifi.com.

[55] Mohammed Amin, "The Taxation of Islamic Finance in Major Western Countries," *Arab Banking Review*. The article can be found on the website: http://pwc.blogs.com/mohammed_amin/files/.pdf

BANKING WITHOUT INTEREST: PROFIT-SHARING CONTRACTS

Avoiding *riba* is the central tenet of Islamic banking. While there is some disagreement over the meaning of *riba*, most religious scholars have interpreted it as interest in all its forms. To avoid interest, Muslim scholars, economists, and lawyers have established a number of interest-free contracts that Islamic banks then adopt in their dealings with depositors (investors) and entrepreneurs.[56] Most of these contracts are named after pre-modern financial contracts that were used hundreds of years ago as part of the commercial law in the Muslim world. While Islamic law forbids interest, the undertaking of commerce and the making of profits is encouraged in Islamic law and there are many details about how the companions of Prophet Muhammad and later generations of Muslims undertook financial transactions while avoiding *riba*. While the modern contracts now used by Islamic banks share many aspects of the pre-modern commercial contracts they emulate, they are also modified to act as alternatives to conventional financial and banking practices in ways that Islamic scholars have judged to be within the purview of Islamic prohibitions on *riba*.

Mudaraba

The *mudaraba* is the most basic form of Islamic banking contract and lies at the heart of the theory of Islamic banking. It was widely used throughout Islamic history,

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[56] For a good description of these various contracts see: Frank Vogel and Samuel Hayes, *Islamic Law and Finance: Religion, Risk and Return*, (Kluwer Law International, The Hague, 1998), pgs. 138-154; Mervyn Lewis, and Latifa Algaoud, *Islamic Banking*, (Edward Elgar Publishing, Cheltenham, 2001), pgs. 39 – 61; and Nicholas Ray, *Arab Islamic Banking and the Renewal of Islamic Law*, (Graham and Trotman, London, 1995) pgs. 37 - 83

including by Prophet Muhammad himself, and is the kind of contract that was discussed by Maududi and other Pakistani scholars in the 1940s as the alternative to interest-based systems. It is also the kind of contract that Mohammed Uzair developed a model for in 1955, thus laying the groundwork for the later establishment of Islamic banks. The *mudaraba* is a contract based on the premise that while Islam forbids interest, it allows for the use of capital to earn profit through legitimate business ventures. In Islamic law, there is a difference between a fixed "rate of interest" and a "rate of return" based on the amount of profit or loss that a business enterprise experiences.

In a *mudaraba* contract, a financier entrusts funds to an entrepreneur to undertake commercial activities in return for a specified share in the profit of those activities. The specified share of the profit must be on a proportional basis and cannot provide for a lump-sum or guaranteed return to the investor. If the activities lose money, the financier will have to bear the full weight of those losses while the entrepreneur loses the time and effort that has been expended. The main difference between interest-based finance and financing based on profit-sharing, is that in the former the financial losses fall upon the borrower who must repay the capital plus a fixed interest rate while in the latter any financial losses that accrue are born completely by the lender while the borrower loses only human capital (in the form of time and effort).[57]

The model that Uzair developed in 1955 has been called the two-tier *mudaraba* with the Islamic bank acting as the intermediary between the depositors (or investors) and the entrepreneurs. The bank receives funds from the public on the basis of unrestricted

[57] Lewis and Algaoud, p. 42

mudaraba in which the depositors trust the banks judgment in properly investing the money (in this situation, the bank is acting as the entrepreneur). The bank then acts as the financier in providing funds to other entrepreneurs for the undertaking of specified projects of specified duration with a separate *mudaraba* contract in which a pre-determined percentage of the profit returns to the bank as well as the eventual return of the capital (unless there was a capital loss in which the bank cannot demand a return that would require the entrepreneur to suffer any financial loss). The bank then aggregates all of the profits it accrues from its various investments with entrepreneurs and returns a percentage to its depositors. In the event of a loss, it is possible that depositors will lose a proportional share or potentially even their entire deposit.

Musharaka

A second related type of contract is the *musharaka*, or partnership contract. The main difference between a *mudaraba* and a *musharaka* contract is that in a *musharaka* contract both parties (the financier and the entrepreneur) contribute capital to a venture and thus can both suffer capital losses. According to most interpretations of Islamic law, those losses must be divided strictly according to capital investment, whereas a larger proportion of the profit can be allocated to the party responsible for most of the partnership's work.[58] *Musharaka* contracts are very similar to venture capital schemes in which financiers are given equity in the venture in which they invest. As partners in the venture the banks accept the risk of loss by the firms. In the event the firm succeeds, the

[58] Ray, p. 63.

bank has a permanent equity investment in the venture that can yield a pre-determined percentage of the profit. The bank's initial investment provides it with shares in the venture that the bank can keep - and thus continue accruing profits - or sell back to the entrepreneur to recover its capital.

While *mudaraba* contracts remain the basis for the deposit side of the banking equation, Islamic banks are much more likely to engage in *musharaka* contracts with investors since the risk that the venture will fail – and the bank will thus lose its investment – is mitigated substantially when entrepreneurs provide a portion of the capital for a venture. However, both *mudaraba* and *musharaka* contracts are far overshadowed by a third type of contract known as *murabaha*, which while far from the original theory of Islamic banking has been found by the majority of Islamic scholars to be *shari'a*-compliant.

Murabaha

The *murabaha* is a sale contract in which a bank buys a good and then sells it to a customer at a marked up price with a delayed payment. For example, a bank could purchase a home for $150 thousand and then sell it to a customer for $200 thousand due in 10 years. While it would seem closer to the spirit of the *shari'a* for Islamic banks to act as merchants in which they purchase many goods and sell them to customers in the market, in reality nearly all *murabaha* contracts undertaken by Islamic banks are commissioned in the sense that a customer commissions a bank to make a specific purchase which the customer agrees in advance to purchase from the bank at a pre-determined markup.[59]

In economic terms, *murabaha* contracts are very similar to interest finance, and Islamic banks base their markup price – even if they don't openly acknowledge it – on LIBOR and other economic indicators. In legal terms however, there are some important differences. Technically, the Islamic bank must own the good which it later sells to the customer and cannot offer a purely monetary loan to a customer. By owning the good, the Islamic bank bears some risks – such as that the goods will be destroyed or that they have defects or that the seller may ultimately decide not to purchase it. Islamic banks have come up with means to avoid these risks – most notably by agreeing with the customer in advance that the second sale (in which the bank sells the good to the customer) occurs at the same instant as the bank gains title under the first sale.

While the theoretical work on Islamic banking focuses on the profit-sharing contracts of *mudaraba* and *musharaka*, about 80 percent of actual Islamic bank investments are consumed in the trade-financing *murabaha* contracts[60] and most of the actual legal and economic discussions about Islamic banking – especially in the initial years - dealt with how to make *murabaha* contracts a *shari'a*-compliant modern alternative to interest finance. As a result of criticisms by some Islamic scholars that many *murabaha* transactions were intentional tricks by bankers aiming at providing interest finance, many Islamic institutions vowed to lower their *murabaha* portfolios.

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[59] Vogel and Hayes, p. 140.
[60] Ibid., p. 135.

Ijara

In the 1990s, leasing (or *ijara*) became the fastest growing activity of Islamic financial institutions.[61] *Ijara* contracts are very similar to conventional leasing contracts and became increasingly used by Islamic banks in the 1990s for the retail financing of home mortgages and the purchases of cars and other household needs through lease-to-purchase agreements. In an *ijara* contract, the banks ownership of the good being leased is not in any doubt and is thus less controversial than the *murabaha* contract. In an example of a lease-to-purchase agreement for a home worth $100 thousand, the bank would pay $90 thousand and the customer would pay a $10 thousand down payment and thus own 10% of the home as opposed to the bank's 90%. The bank would then rent out its 90% of the home to the customer at 90% of the standard rental rate for properties of that nature. In addition to the rental payment, the customer could pay an additional amount that would enable him to own an increasing percentage of the home and thus lower his rental payments over time until taking over complete ownership of the home.

Islamic law demands certain things in an *ijara* contract that make them slightly less flexible than conventional leasing arrangements. For example, the duty to repair the goods always falls on the lessor in Islamic law and Islamic law clearly gives the lessee much broader scope to cancel the lease than is sometimes found in conventional leasing arrangements.[62] In practice many Islamic banks sidestep these Islamic requirements by

[61] Warde, p. 134.
[62] Vogel and Hayes p. 145.

requiring the lessee to insure the property (which is itself controversial in Islamic law) and to require valid legal reasons for breaking a lease.

Sukuk

One of the most important recent innovations in Islamic finance has been the development of an instrument akin to a tradeable bond that for the first time has allowed for the establishment of an Islamic capital market. The *sukuk* can be based either on the *ijara* lease-to-purchase concept or on a *musharaka* basis and involves a number of individual steps – all of which are *shari'a*-compliant – resulting in security instruments that are acceptable to conventional investors and even rated by international rating agencies like Moody's and Standard & Poor's.[63] One of the main differences between a *sukuk* and a conventional bond is that the *sukuk* must be asset-based.

For example, if a government needed to finance the construction of a road, it could sell a stretch of land for say \$500 million to an Islamic financial institution or a special purchasing company (SPC) established solely for the purpose of the transaction. The SPC would then lease back the land to the government for say \$25 million a year for five years with an agreement that the government could fully repurchase the land after five years for the originally paid \$500 million. The SPC would then create a trust in respect of the land and issue a 5-year *sukuk* to raise \$500 million. Beneficiaries could purchase trust instruments that would confer upon them ownership of the land but would

[63] Mohammed Haneef, "Recent Trends and Innovations in Islamic Debt Securities: Prospects for Islamic Profit and Loss Sharing Securities," from S. Nazim Ali ed., *Islamic Finance: Current Legal and Regulatory Issues* (Islamic Finance Project, Cambridge, 2005), p. 35.

require that they accept the conditions of the trust. These instruments would entitle them to a share in the rental income derived from the use of the land and could be bought and sold in a capital market. As the government pays the rental income on the land the *sukuk* holders would gain a proportion of the payments and after the conclusion of the five years when the SPC sells the land back to the government for $500 million, the proceeds from the sale would be returned to the *sukuk* holders.

SIZE AND GROWTH OF ISLAMIC FINANCE

The first *sukuk* was issued by the State of Bahrain in 2001 for $250 million marking a major milestone in Islamic finance.[64] The innovation of the *sukuk* has led to the birth of a rapidly growing Islamic capital market that is allowing Islamic banks to overcome one of the major challenges they have faced since their inception in the 1970s, mainly the inefficiencies caused by having high levels of liquidity - confronted because of the difficulties Islamic banks face in locating short-term investment opportunities. By 2007, Standard & Poor's estimated that the total *sukuk* market had reached $70 billion.[65] In 2008 and 2009 new *sukuk* issuance fell from the 2007 high but in 2010 it regained its rapid growth trajectory and by the end of the year the total *sukuk* market was estimated at $100 billion.[66]

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[64] Haneef, p. 30.
[65] Roula Khalaf and Gillian Tett, "Backwater Sector Moves Into Global Mainstream," *Islamic Finance: Financial Times Special Report*, May 23, 2007, p. 1.
[66] Querbin Minas, "Prospects for Sukuk Market Brighter," *Saudi Gazette*, Dec. 27, 2010, http://www.saudigazette.com.sa/index.cfm?method=home.regcon&contentID=2010122489885

Since the turn of the century, high oil revenues, an increasing sense of Islamic identity across the Muslim world, and innovative new products such as the *sukuk* which have made Islamic finance more competitive, have all contributed to phenomenal growth in Islamic finance. Accurately tracking that growth is difficult since there are currently no aggregate data on Islamic banking across countries. The lack of standardization also presents a problem. There are different definitions of what constitutes true Islamic banking or finance and Islamic banks – lacking the kind of standardization that is present with conventional banks – measure their assets in different ways. Thus while data on the size of individual Islamic banks can be found, just adding them up will not provide an accurate picture of the size of Islamic finance globally.

The best estimate of the size of the assets held in Islamic financial institutions in the year 2000 was $200 billion.[67] In 2005, the General Council of Islamic Banks and Financial Institutions released an Islamic Finance Directory that estimated total assets in Islamic Banks and Islamic banking windows of conventional banks at $450 billion.[68] In 2007, The Banker began publishing an annual report – *Top 500 Islamic Financial Institutions* – that became recognized as the most accurate rendering of the overall size of the Islamic financial industry. In 2010, the Banker estimated that Islamic financial assets

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[67] Warde, p. 1.

[68] The information on the General Council of Islamic Banks and Financial Institutions (GCIBAFI) is quoted as the most accurate estimate by the Islamic Research & Training Institute of the Islamic Development Bank, the Islamic Financial Services Board, and the Islamic Research and Training Institute in a joint paper entitled, "Islamic Financial Services Industry Development: Ten-Year Framework and Strategies," which was posted on the website of the Islamic Financial Services Board (IFSB) in June, 2007 at the site: http://www.ifsb.org/view.php?ch=4&pg=261&ac=26&fname=file&dbIndex=0&ex=1179827227&md=%D1Na%FC%E76%3D%2C%C4%EF.t%60%80%27%BF

had reached $895 billion.[69] Assuming the accuracy of these numbers, it shows an annual increase in Islamic financial assets of nearly 17%. The Banker has made an attempt to include non-commercial banking financial institutions such as Islamic insurance companies and investment banks in its survey but notes that there are clear shortcomings in their ability to fully account for these institutions contribution to the industry as a whole while the Banker also left out some important conventional banks with large Islamic finance windows. The institutions included in their survey do not fully account for the $100 billion *sukuk* industry nor for the totality of money invested in s*hari'a*-compliant mutual funds and *shari'a*-compatible stocks which some had estimated at more than $300 billion in 2005.[70] During the March, 2007 annual meeting of the Islamic Financial Services Board, it was estimated that the entire Islamic Financial Services industry had topped one trillion dollars.[71] Warde, using the same method he used to come up with the $200 billion figure in 2000, estimates that the total size of Islamic financial instruments had reached $1.3 trillion by 2010.[72]

Table 2.1 explains some of this growth over the ten-year period from 1993 to 2003 in comparison to the commercial banking sector which was also growing rapidly in the countries under question. The data for the Islamic bank assets was taken from the Islamic Banks Information System (IBIS) online database which does not include data

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[69] Joseph DiVanna and Brian Caplen, *The Banker: Top 500 Islamic Financial Institutions*, (The Banker, Nov. 2, 2010).
[70] These figures come from the ten-year framework discussed in the above footnote.
[71] The estimate was made by the Governor of the Malaysian Central Bank.
[72] Warde (2010), 1.

Table 2.1 Islamic Bank assets as a share of total bank assets in selected countries

		1993	1998	2003	
Egypt	Islamic Bank Assets	5460.7	6843.63	13946.49	millions of
Faisal Islamic Bank	Total Bank Assets	198250	329562	577937	Egyptian pounds
	Islamic Bank Share	**2.75%**	**2.08%**	**2.41%**	
including:	Islamic Bank Assets			16727.58	
Egypt-Saudi Finance Bank	Total Bank Assets			577937	
	Islamic Bank Share			**2.89%**	
Jordan	Islamic Bank Assets	528.26	706.67	1159.2	millions of
Jordan Islamic Bank	Total Bank Assets	6747.5	10460.3	15701.5	Jordanian dinars
	Islamic Bank Share	**7.83%**	**6.76%**	**7.38%**	
including:	Islamic Bank Assets		843.96	1544.7	
Islamic Int. Arab Bank	Total Bank Assets		10460.3	15701.5	
	Islamic Bank Share		**8.07%**	**9.84%**	
Saudi Arabia	Islamic Bank Assets	28598.49	38055.45	64678.32	millions of
Al-Rajhi	Total Bank Assets	320754	404306	545208	Saudi Riyals
	Islamic Bank Share	**8.92%**	**9.41%**	**11.86%**	
including:	Islamic Bank Assets		42982.04	73667.01	
Bank al-Jazira	Total Bank Assets		404306	545208	
	Islamic Bank Share		**10.63%**	**13.51%**	
Kuwait	Islamic Bank Assets	1156.01	1669.21	3041.11	millions of
Kuwait Finance House	Total Bank Assets	9068.55	12965	18329.85	Kuwaiti Dinars
	Islamic Bank Share	**12.75%**	**12.87%**	**16.59%**	
including other	Islamic Bank Assets	1175.97	1794.66	4075.81	
Islamic investment houses	Total Bank Assets	9068.55	12965	18329.85	
	Islamic Bank Share	**12.97%**	**13.84%**	**22.24%**	

Sources: The Islamic Banks Information System of the Islamic Banks and Finance Division of the Islamic Development Bank, Annual bank reports, and the Central Banks of Egypt, Jordan, Kuwait and Saudi Arabia for the conventional banks that have Islamic window operations and that are prominent in Saudi Arabia, Kuwait, and Egypt.[73] The table measures bank assets rather than the Islamic bank shares of commercial deposits since the lack of standardization means that different Islamic banks measure deposits in different ways. Henry and Wilson have shown that the shares Islamic banks have in commercial bank deposits is higher than these figures on shares in bank assets.[74] The total assets of the Islamic banks as measured by the IBIS database was compared to the overall assets held by the commercial banks in the selected countries as measured by those countries central banks.

In each of the four selected countries, a major Islamic bank had been prominent for a number of years and another Islamic bank was then established during the period of study (in the case of Kuwait, during the period of study three other financial institutions registered with IBIS in addition to the Kuwait Finance House). The table measures both the evolving share of the major Islamic bank as well as the overall share when including the newer financial institutions.

The table shows that growth in the assets held by Islamic banks in Egypt and Jordan as a percentage of overall banking assets is much slower than it is in the wealthier oil-exporting countries of the Gulf. This is also true for non-banking Islamic financial

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[73] The online database can be found at: http://www.ibisonline.net. The Islamic Banks Information System is a project of the Islamic Banks and Finance Division of the Islamic Development Bank. The data in the database was compared against the annual statements of the JIB and the Islamic International Arab Bank and was found to be the same in all cases except the 2003 figures for the JIB, in which the JIB annual statement showed a higher figure for total assets (JD1159.2 million) than shown in the IBIS database (JD 975.49 million). Assuming that a mistake was made in the database figures, the chart shows figures from the JIB annual report for JIB total assets in 2003.

[74] Clement Henry and Rodney Wilson, "Introduction," in *The Politics of Islamic Finance* (Edinburgh University Press, Edinburgh, 2004) p. 7.

practices such as *sukuk*, Islamic insurance (*takaful*), and Islamic mutual funds and other forms of Islamic investments that have grown rapidly in the Arab gulf countries but much more slowly in less wealthy Muslim countries. Since 2003, the share of Islamic banking and other financial practices as an overall share of banking and finance has continued growing, especially in the oil wealthy countries of the Gulf, and – though it may seem overly optimistic - some analysts are now predicting that it could capture half the overall savings of Muslims throughout the world by 2020.[75]

CHALLENGES FACING ISLAMIC BANKING

Since its inception, Islamic banking has been closely linked with the oil market. The first banks were started after the 1973 oil price hike. Many pious Muslims suddenly had excess capital and while they did not want to contradict their religious beliefs they were no longer willing to place their money in non-interest bearing accounts. The clear need for an institutionalized Islamic way to invest such excess capital was largely responsible for the early success of Islamic banks. While Islamic banks stagnated somewhat in the late 1980s and early 1990s during the oil price slump, since the turn of the century they have again witnessed phenomenal growth in the oil wealthy countries of the Gulf where another oil price hike again resulted in excess capital in the region. While certainly there have been a number of important innovations in Islamic finance in the past five years that have made the industry more competitive and enabled it to begin tackling

[75] See May 23, 2007 "Backwater Sector" article by Roula Khalaf.

some of the challenges it faced since its inception,[76] the fact that the recent spurt is again linked to an oil price hike partially masks the fact that many important challenges and problems remain.

Excess Liquidity

A perennial challenge that has faced Islamic banks since their inception has been that they receive more deposits than they can readily and easily invest. Part of the problem is due to the fact that the ideal profit-sharing Islamic investments using *mudaraba* and *musharaka* contracts are inherently risky ventures, especially in non-transparent and accountable political and economic environments in which it is relatively easy for an investor taking a loan from an Islamic bank to hide real profits and thus not pay the bank their full due. The banks are thus left with undertaking simple *murabaha* and *ijara* trade-financing schemes that cannot absorb all the capital deposited in Islamic banks.

Furthermore, the inability of Islamic banks to borrow money in the interest-denominated interbank market means that Islamic banks must keep a comfortable amount of capital on hand to be able to meet the withdrawal demands of clients. The real challenge facing Islamic banks is thus the lack of a well-developed Islamic capital market that can provide Islamic banks with an avenue for liquidity management and more

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[76] For a good recent article on the kinds of innovations that are now being developed for the Islamic financial industry see, Gillian Tett, "Innovation: Frenzied Race to Develop New Ideas," *Islamic Finance: Financial Times Special Report*, May 23, 2007, p. 2.

efficient use of their excess funds.[77] The recent developments in the *sukuk* market may help Islamic banks alleviate this problem as they potentially serve as an Islamic alternative to fixed-interest government treasury bills or bonds, a second major source of secure short-term investments for conventional banks. Currently the *sukuk* market is still very new however and the potential for trading *sukuk* in a secondary market has not yet been realized.[78] The inability to participate in the interbank market or to trade in government treasury bills and bonds and the continued lack of a strong *sukuk* secondary market means that the most viable avenue for Islamic banks to solve their excess liquidity problem is through international commodity transactions based on *murabaha* contracts which pay a lower return than the interbank market.

Competitive Disadvantage

By adopting *shari'a* restrictions on how to place their funds, Islamic banks face a major competitive disadvantage when compared to conventional banks.[79] As a result, Islamic banks pay depositors "profits" on their "investments" that are typically lower than the interest rate – despite the fact that depositors in Islamic banks accept a factor of risk that depositors in conventional banks do not face. The Islamic banks themselves also

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[77] See page 26 of the IFSB ten-year framework for a discussion of this challenge.

[78] See Standard & Poor's Commentary Report, "The Islamic Financial Industry Comes of Age," Oct. 25, 2006, page 4 where it is mentioned that the secondary market for *sukuk* remains virtually nonexistent.

[79] For a good discussion of the kinds of competitive disadvantages faced by Islamic banks and empirical analyses comparing the performance of Islamic and conventional banks see Clement Henry, "Financial Performances of Islamic versus Conventional Banks," in Clement Henry and Rodney Wilson ed., *The Politics of Islamic Finance*, (Edinburgh University Press, Edinburgh, 2004) pgs. 104-128 and Munawar Iqbal, "Islamic and Conventional Banking in the Nineties: A Comparative Study," *Islamic Economic Series*, Vol. 8, No. 2, April 2001.

invest in comparatively riskier private sector investments than do their conventional counterparts who impart a substantial proportion of their funds in guaranteed t-bills, bonds and the interbank market. Islamic banks also have more monitoring and transaction costs than do conventional banks. All of these competitive disadvantages make it difficult for Islamic banks to compete with conventional banks and move beyond a niche market of pious Muslim customers who are willing to accept less (and pay more for loans/investment capital) than can be obtained from conventional banks. The growth of Islamic banking until very recently was thus more an indicator of the percentage of Muslim faithful willing to pay that premium than the performance of the Islamic banking sector as a whole.

Recent financial and legal innovations may allow Islamic banks to use not only something akin to bonds but even derivatives and other kinds of structured finance[80] that will lessen the competitive disadvantages faced by Islamic banks. Such innovations however remain controversial from the religious perspective and as new innovations make Islamic banking look closer and closer to conventional banking it may lose its raison d'etre and its most loyal customer base.

The Lack of Standardization

One of the biggest challenges facing Islamic banks is the lack of a common framework for governing, supervising, and regulating them. This has become an increasingly serious issue with the internationalization of financial markets over the past

[80] See Tett, p. 2.

20 years and the birth of a truly global regulatory regime, marked by the 1988 Basle Accord and the 2004 Basle II Accord.[81] The Basle Accords have established a number of regulatory rules and norms that banks must adopt before they can become part of the global financial system. Those rules and norms were however established for interest-based dealings and Islamic financial institutions have faced a number of challenges in meeting them with interest-free products. These challenges are mitigated somewhat by the fact that the international financial regulatory bodies have proven to be flexible in allowing for differences across regulatory systems and have worked closely with Islamic bankers and economists to find *shari'a*-compliant ways to meet the regulatory demands of the international system.

The real challenge is for Islamic bankers throughout the world - as well as the governments in which those banks exist - to agree on a common system and principles for regulation and supervision, accounting and *shari'a*-compliance. This challenge is well-recognized and has been the subject of numerous conferences and summits over the past few years. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), established in Bahrain in 1991, was the first organization to attempt to construct internationally acceptable standards for Islamic banking. According to its website, the AAOIFI has "now issued 56 standards on accounting, auditing, governance, ethical, and *shari'a* standards, including a statement on capital adequacy."[82]

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[81] For an exposition of the global financial regulatory regime and the place of Islamic institutions within it see Ibrahim Warde, Islamic Finance in the Global Economy, (Edinburgh University Press, Edinburgh, 2000) pgs. 180 – 204.
[82] See website for the Accounting and Auditing Organization for Islamic Financial Institutions at: http://www.aaoifi.com

However, only eight countries have adopted the AAOIFI standards as mandatory though many Islamic financial institutions in other countries have voluntarily adopted them.[83] Since no universally accepted accounting standards for Islamic banks yet exist, it is difficult to compare Islamic banks across countries or to obtain accurate aggregate data on Islamic banking.[84]

The Islamic Development Bank (IDB) has also been playing a key role in developing internationally acceptable regulatory standards and procedures for Islamic banks and getting them adopted in member countries. The IDB and AAOIFI began an extensive consultative process with the International Monetary Fund (IMF) and a number of central bank governors in 2000 that culminated in the establishment of the Islamic Financial Services Board (IFSB) in 2002 with the primary objective of setting and disseminating standards for the supervision and regulation of Islamic banks that are consistent with both the *shari'a* and international standards and norms.[85] While the organizational structure for the establishment of Islamic financial regulations and norms has expanded tremendously over the past few years, the hurdles they face in coming up with agreed upon standards and norms remain large.

One of the major complicating factors is that there is no agreed upon definition of what is *shari'a*-compliant and the definitions of certain Islamic financial products differ from one country to another or even within two Islamic institutions in the same country.

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[83] Roula Khalaf, "Supervision and Regulation: Experts See Need for a Common Approach," *Islamic Finance: Financial Times Special Report*, May 23, 2007, p. 3.
[84] Mohammed El Qorchi, "Islamic Finance Gears Up," Finance and Development, (IMF, Dec. 2005), Vol. 42, no. 4.
[85] International Monetary Fund, "IMF Facilitates Establishment of Islamic Financial Services Board," News Brief no. 02/41, May 1, 2002 seen at: http://www.imf.org/external/np/sec/nb/2002/nb0241.htm

Currently nearly every Islamic bank has their own *shari'a* board which passes rulings on what kinds of products a specific bank can or cannot engage in. The religious scholars that sit on different boards often disagree with each other on what constitutes *shari'a*-compliance with the result that some Islamic banks practice financial dealings that other banks consider religiously forbidden and that certain Islamic financial products are defined very differently in one bank than they are in another.

Appropriate Legal Framework

The challenge of excess liquidity, many of the competitive disadvantages faced by Islamic banks, and the problems of standardization and regulation are all linked in one way or another to the manner by which the state deals with Islamic banks. While in many countries, conventional banks complain that the state provides "special privileges" to the Islamic banking sector,[86] Islamic banks face the challenge of working in legal environments in which commercial codes were established to accommodate interest-based financing. In nearly all Muslim countries today, civil and commercial codes were inspired by European laws and in situations in which Islamic prescriptions contradict national laws the national laws will almost always be enforced.[87]

In addition to the problems of legal enforceability, there are other practical problems in the government-Islamic bank relationship. For example, the capital gains that

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[86] See Warde (2000) page 197 and 198 for a discussion of some of the special privileges awarded Islamic banks in Egypt and Turkey.

[87] See Vogel and Hayes, pages 50 – 52, for a discussion of the difficulties Islamic banks face in enforcing Islamic laws in Muslim countries with Western-inspired legal environments.

Islamic banks pay their depositors are often taxed at higher rates than the interest payments paid out by conventional banks.[88] The most important challenges Islamic banks face in their relationship with governments involves the manner by which the Central Banks deal with Islamic finance. In nearly all states, Islamic banks lack a supportive regulatory environment from Central Bank authorities that would offer them *shari'a*-compliant lender of last resort facilities and *shari'a*-compliant returns on bank reserves held at Central Banks. While there has been some theoretical discussions concerning how the Islamic Development Bank could provide such services to Islamic banks on an international basis, the practical challenges of implementing such an idea remain difficult to surmount.

Practical Impediments to Equity Financing

A perennial complaint about Islamic banks is that they have strayed far from the ideal theoretical premise of profit and loss sharing. The fact that they deal overwhelmingly in *murabaha* transactions is seen by many as a challenge that Islamic banks must overcome. In principle, Islamic banks are supposed to deal less in debt financing and more in equity financing.

Looking at aggregate data from a number of Muslim and non-Muslim countries, Tarik Yousef has shown that the ratio of debt financing in an economy as opposed to equity financing (through stock market capitalization) is closely correlated to the legal, institutional and political structure of the country and that the predominance of *murabaha*

[88] Ray (1995), page 22.

and *ijara* contracts in Islamic banks as opposed to the equity financing schemes of *mudaraba* and *musharaka* contracts conforms to what is predicted theoretically and is seen in other regions of the world.[89] Yousef's analysis shows that the challenge of moving toward more equity financing schemes is less a challenge that Islamic banks are capable of overcoming as it is a challenge facing Muslim countries that must reform the structures of their countries to allow for a more robust rule of law, better bureaucratic quality with less corruption, and more democratic institutions and procedures.

DISPUTES OVER ISLAMIC BANKING AND FINANCE

The birth and rapid growth of Islamic banks in recent decades has not come without controversy. One dispute is over the definition of *riba.* While the majority of Islamic scholars argue that all kinds of interest are forbidden forms of *riba* there is an argument that *riba* should be defined as excessive usury that does not include regular forms of bank interest. According to this argument, there is nothing Islamically wrong with dealing with conventional structured financial systems that are based on moderate interest rates. A second and somewhat contradictory criticism is that all current modes of Islamic finance use disguised forms of interest and are thus not truly Islamic.

Both these arguments were discussed by Mahmoud El-Gamal, who argues that the current practice of Islamic finance has strayed from the objectives of Islamic Law and that by reviving medieval contracts and using ancient Arabic terminology, Islamic banks

[89] Tarik Yousef, "The Murabaha Syndrome in Islamic Finance: Laws, Institutions and Politics," from Clement Henry and Rodney Wilson ed., *The Politics of Islamic Finance* (Edinburgh University Press, Edinburgh, 2004) pgs. 63-80.

give a veneer of Islamicity to a practice that is in fact just as interest-based as conventional financial practices, only with some extra costs.[90] El-Gamal criticizes those who declare that all forms of interest are forbidden *riba* and then turn around and re-engineer interest-based products in ways that are only technically interest-free. He stresses that the real work of Islamic finance should move away from contract forms and more into the substance of meeting the social and economic needs of society in ways superior to those that currently exist.

Riba: Interest or Usury

While the Quran and various sayings of Prophet Muhammad emphatically denounce the evils of *riba* and make its prohibition clear, the definition of exactly what *riba* entails has been controversial since soon after the death of the Prophet. There are reports that some of the early Companions, most notably Umar ibn Al-Khattab, expressed the wish that *riba* had been explained in more detail.[91]

In the late 19th and early 20th Century a debate began in Egypt when the government issued interest-bearing postal savings accounts as a way for the government to collect needed capital while allowing citizens to save money. While many Egyptians refused to take the interest on their accounts, some Muslim scholars, including the well-respected Mohammed Abduh, Rashid Rida and Mahmud Shaltut argued that under such situations pre-specified “profit rates” that clearly benefited both investors and the

[90] Mahmoud El-Gamal, Islamic Finance: Law, Economics, and Practice, (Cambridge University Press, New York, 2006).
[91] See Vogel and Hayes p. 63.

economic development needs of the country did not entail the forbidden forms of *riba*. In 1934, Abdullah Yusuf Ali, an Indian scholar, wrote what remains until today the most recognized and widespread English translation of the Qur'an. In his commentary of verse 275 of Chapter 2 which discusses the prohibition of *riba*, Yusuf Ali wrote that he disagreed with the majority of the religious scholars who defined *riba* as all kinds of interest and that his definition would exclude "economic credit, the creature of modern banking and finance."[92]

More recently in 1989, Sheikh Muhammad Sayyed Tantawi, who was the Grand Mufti of Egypt – or chief Islamic lawmaker – at the time, issued a religious ruling in which he clearly stated his belief that certain interest-based government investments did not constitute the forbidden forms of *riba.*[93] When his ruling raised a storm of controversy, he retorted by going even further to announce that interest-bearing deposits at conventional banks were perfectly Islamic and that conventional banks were in fact closer to the true spirit of Islam than the "Islamic" banks which imposed additional costs on their customers. Tantawi and a number of other government-appointed religious leaders in Egypt have repeatedly argued since that ruling that mutually agreed upon pre-specified profit rates – or interest – by government-regulated banks are Islamically legitimate. While most religious scholars have vehemently disputed Tantawi's conclusions and some have gone so far as to accuse him of making religious rulings to

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[92] Abdullah Yusuf Ali, *The Holy Qur'an: Translation and Commentary*, (American Trust Publications, 1977) p. 111. Yusuf Ali's comments about his disagreement with the main body of scholars on the definition of *riba* was removed from later editions of the translation and commentary published after 1992.
[93] Vogel and Hayes, p. 46.

please government officials, his arguments have found resonance in some circles in the Muslim world.

Islamic Banks: Practice and Ideal

Many Muslim critics of Islamic banks assert that they are not really applying Islamic law but are merely using Islamic terminology to do the same things as conventional banks. While Islamic banks claim that they follow the Islamic requirements of having asset-based rather than financial-based products, they have incorporated numerous clauses into their contracts that lessen to nearly zero the risks that are incumbent upon holding assets. In the most obvious example, Islamic banks rarely buy homes or cars and then sell them to customers with a markup without first requiring customers to sign a binding "promise to purchase" clause.[94]

Similar clauses exist in *ijara* and *sukuk* contracts that lessen the risks that a truly asset-based approach would entail. While such clauses are controversial Islamically they have become the standard practice of Islamic banks and financial institutions. As El-Gamal has shown, the standard practice of Islamic banking is to identify a conventional financial product and then construct an Islamic "analog" to it by breaking down the product into its parts and engineering Islamically acceptable alternatives at each step.[95] This process is similar to what many Islamic scholars deem "ruses" that allow people to attain Islamically illegal ends through legal means. While in Islamic Law such processes

[94] See Ray, pgs. 51-54.
[95] See El-Gamal, pgs. 20 and 21.

are often deemed legal, those who intentionally engage in them are considered "sinful." Many critics of Islamic banks point out that the banks have not attained the ideal that was promulgated by the theoreticians of the 1940s and 1950s who wrote how "Islamic economics" was a superior alternative to the Western system and that replacing an interest-based financial system on a fairer profit and loss-sharing system would better serve the social and economic needs of the poor while also proving to be a better engine for economic development.

CONCLUSION

This brief overview of Islamic banking underscores one of its greatest paradoxes – despite overwhelming challenges including a lack of standardization, a severe competitive disadvantage, a less than ideal legal framework in most of the world, structural impediments that weigh against the kind of financing at the heart of Islamic banking, and continued disputes over what Islamic banking even is, the industry has continued to grow at a phenomenal rate. This growth has occurred despite rather than because of economic rationality and can only be explained through a more nuanced political, cultural, and social explanation. Different historical and political trajectories led Islamic banking and finance to grow in certain Muslim countries faster than in others and an analysis of any one country's experience with Islamic finance cannot explain the situation throughout the entire Muslim world. However, only through a more detailed analysis of one country's experiences can a clearer understanding of the phenomenon of Islamic banking and its potential future role be explicated.

One of the most interesting political questions raised by the growth of Islamic banking is its relationship to Islamist political movements which have also experienced phenomenal growth rates in the Muslim world since the 1970s. While the relationship between Islamic finance and Islamist politics is different in different countries, the most interesting analysis of the relationship can be undertaken in a country in which both have been allowed to grow within a relatively free political and economic environment. The most obvious country in which that has occurred is Jordan, a country which has been a pioneer in Islamic Banking and in fact provided Islamic banking in the 1970s with the ideas and theories that continue to form the framework and structure of Islamic banking until today and at the same time has had one of the largest and most well-established Islamic movements in the region. The state in Jordan is less imposing than many other states in the region and both the Islamic movement and Islamic finance have been able to function in a relatively liberal arena removed from direct state control. It is in just such an environment in which it is most interesting to look into the relations between Islamic finance and Islamic political movements and to see how those relationships impact upon larger political and economic questions.

The nature of the Jordanian economy also makes it an ideal case for looking further into the role of Islamic finance in the political and economic development of a country. Jordan is a middle-income country that neither suffers extreme poverty nor enjoys the luxury of abundant natural resources. While most of the current growth in Islamic finance is taking place in the oil-rich Arab Gulf countries, it is in the more middle income countries that the growth requires an explanation and also has the potential to have more of an impact. Jordan faces severe economic challenges – not the least of which is its overwhelming dependence on various forms of economic rent. The economic challenges Jordan faced in the late 1980s and early 1990s when those rents were removed and Jordan was forced to tackle major structural economic problems – at the very time that Islamic financial and Islamist political movements were at the peak of their strength – provides an interesting laboratory for the study of the interplay between Islamist political movements, Islamist financial movements and the state.

To the extent that Islamic banking represents a quest for cultural authenticity in a region of the world where the lack of political legitimacy has been an important inhibiting factor, Jordan is also an ideal case study. Since the breakup of the Ottoman Empire and the division of the Arab world by the colonial powers, issues of identity and cultural authenticity have been dominant political themes. States have been forced to establish legitimacy and defend their borders in the face of both subnational and supranational identities. Jordan, established as a colonial afterthought with no real historical basis, has faced continuous issues of authenticity, legitimacy, and identity at the heart of its state-building enterprise. The extent to which Islamic banking is the result of this quest as well as the role it can play in answering the questions the search for authenticity and legitimacy have brought up, can thus best be explored in a country like Jordan.

CHAPTER THREE: POLITICAL-ECONOMIC HISTORY OF JORDAN

Jordan has been transformed in less than 100 years from an under-populated largely Bedouin entity with no significant urban concentrations and a barter economy into a modern state with a sophisticated financial system. The story of that transformation is largely a story about how the state's geographic position gave it a political significance which the state's leaders were able to leverage in the international arena for the economic benefit of the country. International politics and foreign policy-making has had a greater impact on the economic development and socio-economic structure of the country than actual economic policies or structural reforms. The massive transformation that took place in Jordan without concomitant structural reform left the country vulnerable as the internal sources of revenue have not grown enough to meet the needs of its sophisticated economy and the leadership remains dependent on leveraging its geographic position to accrue outside support.

Since its establishment, Jordan's need for external sources of revenue has had a profound impact upon its political system. Even before its founding as a British mandate in 1921, the region was the recipient of large rents. As Luciani has pointed out, the political dynamics of states that derive a substantial amount of their revenue from rents accruing from the outside world are very different from the dynamics of states where the government must obtain its revenue base through taxation of domestic economic activity.[96] Luciani posits that there is a correlation between the presence of rents and the lack of democratization. The Jordanian example provides strong support for this theory. The most meaningful political and economic reform to ever take place in Jordan occurred in the late 1980s and early 1990s at a time of rent scarcity.

For decades the stability of the monarchy rested on two pillars. First, its ability to use its externally-derived rents to establish generous support networks that gained it the support of the large and powerful East Bank tribal communities. Second, its ability to maintain the support of the Muslim Brotherhood, the country's largest grassroots social and political movement, which for various reasons was aligned with the monarchy on crucial political and social issues. The Brotherhood's support was critical in that it provided the monarchy with political legitimacy among a large segment of the lower and middle class Palestinians, who formed the majority of the country's population. The legitimacy garnered through these two bases of support enabled the monarchy to weather severe political crises in the 1950s and 1960s and a civil war in the 1970s.

A number of events in the late 1980s – most notably the dramatic fall in international oil prices and political instability in the adjoining West Bank - had a profound impact on Jordan's economy and its ability to continue accruing rents. For the first time in its history, the country was forced to undertake meaningful economic reform that would enable it to establish a viable economy. A decade of reform upset the delicate balances of power and networks of patronage that had been built up during the era of

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[96] Giacomo Luciani, "The Oil Rent, the Fiscal Crisis of the State and Democratization," from Ghassan Salame ed., *Democracy Without Democrats? The Renewal of Politics in the Muslim World*, (I.B. Tauris and Co., London, 1994) pgs. 130-155.

large rents. The stability of the country was threatened during a decade in which the monarchy attempted to gain new sources of regime support – mainly through political liberalization and economic policies that gained the support of the country's wealthy business elite - as it lost some of its older, more traditional bases in the East Bank tribal communities.

Meanwhile regional events – most notably American-led wars in Iraq, and a prolonged peace process involving the Palestinians and Israel - again enabled Jordan's leadership to leverage the country's strategic geographic position and by the early part of the new century, Jordan had regained substantial external sources of rent. That rent however came at the price of both political and economic reform. The foreign policies adopted to gain those rents were unpopular and to maintain them the regime had to backtrack on important political reforms that had taken place in the 1980s and early 1990s. The unpopular foreign policies and the curbing of democratic political reforms alienated the Muslim Brotherhood. While the Brotherhood had been a crucial source of stability for the monarchy in earlier decades, by the turn of the century it had become the major source of ideological opposition in the kingdom.

The new rents also allowed the regime to postpone economic reforms needed to establish a viable economy based on internal sources of revenue. It however remains unclear how stable the regime would be in the event of a real economic or political crisis. This dissertation explores the potential of Islamic banking to serve as a bridge that can allow Jordan to continue economic reform policies that will bring about the kind of viable economy the monarchy seeks while winning back enough Islamist support to provide the regime with the legitimacy it needs to remain stable. Understanding the political challenges currently facing the Jordanian regime and the socio-economic structure of the country requires a fuller historical analysis of Jordan's political economy. This chapter provides a historical perspective to Jordan highlighting the central role external rents have traditionally played in the politics and economy of the country.

JORDAN UNDER OTTOMAN RULE

The area that later came to be called Transjordan and then Jordan came under Ottoman rule in 1517 and remained so until the end of World War I. Under the Ottomans, what is now known as Jordan never constituted a unified administrative entity but was rather part of three different regions – southern Syria, central Palestine, and the northern Hijaz. For the first 300 years of Ottoman rule, there was very little Ottoman administrative presence in the area. While the region was peripheral and largely inhabited by nomadic and semi-nomadic Bedouins, it did occupy a strategically important location along the annual Hajj caravan routes to the holy cities of Mecca and Medina. This strategic location enabled Bedouin tribal leaders to extract subsidies (an early form of external rent) from the Ottomans in return for ensuring the safety of caravans traveling through their domains.[97]

By the nineteenth century, about half the population of the area had settled in small agricultural villages. Starting in the 1840s, the Ottomans began reasserting

[97] Abla Amawi, "State and Class in Transjordan: A Study of State Autonomy," (Ph.D. Dissertation, Georgetown University, 1993) p. 75.

administrative control over the area by establishing a number of garrisons that would allow for a modicum of security, curb tribal raiding of the small villages and enable the central government to extract taxes from the settled population. A sign of the increased security was the 1908 completion of the Hijaz Railway through Jordanian territory. The railway linked Medina to Damascus and other northern cities. With the increased security, merchants from Syria and Palestine began settling in Jordan. Circassian and Chechen refugees from the Caucasus also immigrated to the region at around the same time, settling mostly in Amman.

The arrival of these new immigrants began changing the socio-economic structure of Jordan. Trade increased dramatically and Jordanian agricultural products – most notably wheat – began being exported. At first, the trade was largely undertaken through barter. Money transactions remained limited with the money that was used generally being gold or silver coins that had an intrinsic value.[98]

However as merchants with access to capital became increasingly interested in the region, rudimentary financial transactions began taking place, usually in a manner that ultimately proved deleterious for the financially inexperienced Jordanian landholders and peasants.[99] The merchants loaned money to cultivators who needed capital to pay taxes or cover agricultural expenses. In return for cash grants, farmers would provide a part of

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[98] Ibid., p. 89.

[99] Information about early forms of money-lending in Jordan can be found in Eugene Lawrence Rogan, *Frontiers of the State in the Late Ottoman Empire: Transjordan 1850 – 1921*, (Cambridge University Press, Cambridge, 1999), Michael Richard Fischbach, "State, Society, and Land in Ajlun (Northern Transjordan), 1850-1950" (Ph.D. dissertation, Georgetown University, 1992), and Mustafa Hamarneh, "Social and Economic Transformation of Trans-Jordan, 1921-1946," (Ph.D. dissertation, Georgetown University, 1985).

the harvest to the lender; or, in other cases, loans were contracted against land as collateral. In these latter cases, the lender would enjoy the rights to a piece of land and its produce for a temporary period of time. Many of both kinds of these loans were contracted outside of the legal Islamic courts and were undertaken at usurious rates that led to peasant indebtedness for life as well as the permanent transfer of substantial amounts of land from tribal shaykhs to the merchants, who by the early 20th century had emerged as the economic, landed, and commercial elite of the country.

WORLD WAR I AND THE BRITISH MANDATE

The defeat of the Ottomans in World War I and the subsequent dismemberment of the Ottoman state removed the security framework that had recently been established in Jordan. Based on secret British and French agreements that were concluded during the war, Jordan became part of a British mandate and the British installed Emir Abdullah, from the prestigious Hashemite family of the Hijaz (in present-day Saudi Arabia) on the throne of a Kingdom the British created to serve its imperial interests. At the time, Jordan was still a peripheral region but was seen as strategically important because of its geographic location. For the British, Jordan was to serve as a bridge connecting the more important British-occupied areas of Palestine and Iraq as well as a buffer between the French who occupied Syria to the north and the Wahhabi religiously-inspired tribal expansionist movement that had taken over Saudi Arabia to the south.[100]

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[100] Philip Robins, *A History of Jordan*, (Cambridge University Press, Cambridge, 2004), pg. 13.

Abdullah's initial desires to expand his own realm were quickly frustrated by British opposition as well as realities on the ground. Under British tutelage, Abdullah established an administrative bureaucracy and a modern army that gave the new Kingdom security both internally as well as from outside threats – mainly from the Saudi Wahhabists. Policies were adopted to integrate the Bedouin into sedentary society through land settlement. Initially the British-led army, known as the Arab Legion, was made up largely of Arabs from outside of Jordan, and one of its main tasks was to pacify the large areas of the country still under the sway of the Bedouins. However, with time, the Bedouin tribes began staffing the Arab Legion, both out of economic necessity and out of the realization that it provided them with a means of maintaining their influence after the establishment of state institutions.[101]

In addition to providing extra security, a main goal of the policy of settling the Bedouins was increasing the agricultural tax base of the country. The increase in taxes however remained marginal and Jordan continued to rely overwhelmingly on British support or "grants-in-aid." This form of rent usually accounted for more than 50 percent of total state revenue throughout the mandate period.[102] Abdullah also relied on the wealthy Syrian and Palestinian merchant families who had immigrated to Jordan in the late 19th and early 20th century as a source of funds that would give him some independence from British authorities. In 1923, these merchants founded the Amman

[101] Ibid., pg. 42.
[102] Pete Moore, *Doing Business in the Middle East: Politics and Economic Crisis in Jordan and Kuwait*, (Cambridge University Press, Cambridge, 2004), 62.

Chamber of Commerce which quickly became a center of economic and political influence in the country.[103]

The first bank in Jordan was established in 1925, when the Ottoman Bank opened a branch in Amman.[104] The Palestinian-based Arab Bank opened a branch in Amman in 1934.[105] With the presence of these banks, a financial system began to take shape and more capital became available to finance the merchant trade. This trade expanded considerably during World War II when the Jordanian port of Aqaba became an important center for the importing and re-exporting of goods used by the British authorities in Jordan and Palestine. The wealth of the Jordanian business elite increased dramatically during the war.[106]

In the Aftermath of World War II

Soon after World War II, the British withdrew from the region and Jordan gained formal independence in 1946. The Zionist Movement was able to take over the majority of Palestine at around the same time. The Palestinian West Bank became part of Jordan after the 1948 Arab-Israeli war and with the new land and the hundreds of thousands of Palestinian refugees from the areas that had come under Israeli occupation, the population of Jordan tripled between 1948 and 1950.[107] The merchant communities in

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[103] See Moore (2004) pgs. 57-66.
[104] Abdullah Abd al-Majeed al-Maliki, *The Jordanian Central Bank and Financial Policy: Vol. 1 Encyclopedia on the History of Banking in Jordan*, (Jordan Printing and Publishing, Amman, 1996) pg. 19.
[105] Abdullah Abd al-Majeed al-Maliki, *The Arab Bank: Vol. 5 Encyclopedia on the History of Banking in Jordan*, (Jordan Printing and Publishing, Amman, 1996) pg. 18.
[106] Moore (2004) pgs. 64-66.
[107] Ibid. pg 68.

Jordan became increasingly made up of Palestinians as did the urbanized population in general. The decreased aid from Britain was replaced by American aid. From 1956 to 1966, the United States – recognizing the importance of Jordan's geostrategic position - provided almost 50 percent of Jordan's external revenue and from 1959 to 1970, foreign aid as a percentage of GDP averaged 22 percent annually.[108] The other main source of revenue during this period was the customs imposed on imported goods.

Social, political, and economic events in Jordan were largely defined by the Palestinian issue in the decades following World War II and the establishment of Israel in 1948. With the large influx of Palestinians, the population became higher-educated and wealthier and the country experienced sustained growth of about 8 percent throughout the 1950s and 1960s.[109] The Palestinian-owned Arab Bank moved its headquarters to Amman in 1948 and quickly gained a reputation as one of the strongest and best managed banks in the Arab world.[110] However, the strong Palestinian desire for the return of their homeland also led to the establishment of political movements that at times threatened Jordan's political stability. Jordan's King Abdullah was assassinated by a Palestinian nationalist in 1951. His grandson, King Hussein – who had acceded to the throne in 1952 after a brief interlude led by King Talal – was nearly overthrown in 1957 by army units that had a strong base of support in the elected parliament.

After the events of 1957, King Hussein dissolved political parties in the country, declared martial law, and began suppressing the radical leftist and nationalist groups that

[108] Ibid. pg. 67.
[109] Timothy Piro, The Political Economy of Market Reform in Jordan, (Rowman & Littlefield Publishers, Lanham Maryland, 1998) pg. 30.
[110] Al-Maliki (1996), pg. 20.

were popular among the Palestinian segments of the population. Hussein increasingly relied for support on the Bedouin tribes. Their earlier co-optation into the military and police and their own fears of increasing Palestinian encroachment in the country made them loyal allies of the monarchy.

THE MUSLIM BROTHERHOOD IN JORDAN

In addition to the support of the tribes, King Hussein had the support of the Muslim Brotherhood, an international Islamist movement that was being violently suppressed in Egypt, whose leader Gamal Abdul Nasser was the ideological leader of the nationalist and leftist opposition groups trying to oust King Hussein. The Muslim Brotherhood's support for Hussein in 1957 enabled it to remain the only political force in the country that escaped the ban imposed on political activism and it was able over the ensuing decades to build a strong foundation of support throughout the Kingdom with the establishment of a number of charitable, educational, and healthcare institutions.

The Muslim Brotherhood had been founded in Egypt in 1928, a few years after the dissolution of the Ottoman Empire and the fall of the Khilafa, the symbolic institution unifying and maintaining the Islamic character of the Muslim world. The Brotherhood was founded with the objective of uniting the Muslim world under the banner of an Islamic state that ruled according to the *shari'a*. The Brotherhood quickly spread beyond Egypt and chapters were formed throughout the world. In 1945, chapters were formally opened in both Jerusalem and Amman and the movement spread quickly in both Palestine and Jordan. After the 1948 war, the Palestinian and Jordanian movements merged. While the majority of the members in the Jordanian branch of the Muslim Brotherhood were Palestinian, the movement was headed by East Bank Jordanians, who were able to maintain cordial ties with the monarchy despite opposing many of its policies.

The Brotherhood came to be seen as a loyal opposition. The movement often criticized the Jordanian regime for its pro-British and later pro-American foreign policy orientation, for its lack of action on working to liberate Palestine and for the non-enforcement of Islamic law in the country. At times such criticism became heated and there have been many periods in Jordanian history during which Brotherhood members and leaders were harassed and arrested. However, the Brotherhood – unlike some of the leftist and nationalist groups in the country – never questioned the legitimacy of the monarchy. They also remained loyal supporters of King Hussein's decision to incorporate the West Bank into Jordan. Since the early 1950s and especially after the establishment of the Palestine Liberation Organization in 1964, the call for an independent Palestinian state including the West Bank was popular in Palestinian circles and throughout the Arab world. The Jordanian monarchy was nearly alone in its assertion that the West Bank should remain part of the Jordanian state. The Brotherhood's acceptance of that position cost it support and legitimacy in Palestinian circles.

Even after the 1967 war, during which Israel occupied the West Bank, the Jordanian Brotherhood continued to support King Hussein's position that the West Bank should return to Jordanian control, though such a position had almost no popular support among lower and middle-class Palestinians, who overwhelmingly desired an independent state. The Brotherhood's stand on the issue was based on the principle of preserving Jordanian-Palestinian unity until an eventual unification of the entire Muslim world. As an ideological group with a mass base of support, the Brotherhood's stance on the West Bank issue as well as the preservation of the monarchy itself provided the regime with legitimacy. That legitimacy proved crucial to the monarchy in times of real crises, such as the 1957 coup attempt and the 1970-71 Civil War, when the Brotherhood stood staunchly behind the regime.

While members of the Muslim Brotherhood were being violently persecuted in many parts of the Arab world, the Jordanian branch had the good fortune of having the same political rivals as the Jordanian monarch. During the heyday of Arab nationalism in the 1950s and 1960s, the Egyptian and Syrian regimes openly derided Jordan as an artificial entity serving imperialist interests and the Jordanian monarchy as a British invention. While those regimes were calling for the overthrow of King Hussein they were also persecuting the Muslim Brotherhood within their countries. With the same political rivals, the Jordanian branch of the Brotherhood and King Hussein found means of cooperating and overlooking their own political differences.

The Jordanian regime often provided political asylum to many Egyptian and Syrian members of the Brotherhood. One Egyptian member of the Brotherhood, Kamil al-Sharif, later went on to become a Minister in the Jordanian government and an appointed member of Jordan's Upper House of Parliament. In the late 1970s and early 1980s when open conflict flared in Syria between the regime and the Brotherhood there, the Jordanian members of the Brotherhood opened "training camps" in northern Jordan and provided other support infrastructure to the Syrian Islamists with the full support of the Jordanian regime, which was able to use its strong ties to the Brotherhood as a tool that enabled it to achieve some of its foreign policy objectives against Syria.

THE 1967 ARAB-ISRAELI WAR AND THE 1970-71 JORDANIAN CIVIL WAR

In 1967, Israel invaded and occupied the West Bank and Jordan lost a significant portion of its country including some of its most economically productive areas. The West Bank had come to represent about 40% of Jordan's GDP and half of its industrial capacity.[111] While the overall population of Jordan was significantly reduced by the loss of the West Bank, an additional 300,000 Palestinian refugees flooded into Jordan during the war swelling the population in the already existent refugee camps with people angered with the weak performance of Jordan and the other Arab states in the war against Israel and increasingly believing that only Palestinian guerrilla action could liberate their country. Nationalist Palestinian groups organized under the PLO umbrella flourished in Jordan and began taking on the trappings of a state within a state. Tensions between the Jordanian state and the Palestinian groups reached a head in September 1970 when a bloody Civil War broke out and culminated with the expulsion of the Palestinian organizations from Jordan.

The Civil War had a detrimental impact on Jordan's economy, shutting down commerce and closing many trade routes. Industrial and agricultural production fell

[111] Robins (2004) pg. 124.

dramatically and there was a flight of capital from the country.[112] Jordan's annual GDP fell by 15% during the war.[113] While the war exacerbated the already tense relations between Palestinians and Jordanians living in the kingdom, the Muslim Brotherhood – with its overwhelmingly Palestinian grassroots membership – as well as the business elite, which was also almost fully Palestinian, allied themselves with the throne.

As the PLO had established its state within a state in Jordan, many wealthy Palestinians had become disenchanted with the PLO's arbitrary actions and the instability they were engendering. In the Amman Chamber of Commerce elections which took place on September 15, 1970, just two days before open hostilities broke out, pro-PLO candidates were completely defeated in what had become a fully Palestinian institution in Jordan. The Muslim Brotherhood was the only large organization with a strong following among poorer Palestinians that also clearly supported the throne. As in 1957, the Brotherhood's support at a crucial time helped cement its relationship with the monarchy – a relationship that the Brotherhood did not enjoy in any other Arab country.

THE RISE OF OIL PRICES AFTER 1973

After the 1967 war, the Arab countries held a summit in which they promised to provide substantial aid to the "frontline" Arab states bordering Israel. Jordan was one of the greatest recipients of this form of rent. After the 1970-71 Civil War, public opinion in the wider Arab world moved decisively against Jordan and there was a brief cessation

[112] Piro (1998) pg. 60-61.
[113] Moore (2004) p. 102.

of Arab aid.[114] Such aid was however revived after Jordan's symbolic participation in the 1973 Arab-Israeli war and the subsequent rise in oil prices.

The oil price hike brought substantial flows of capital to the oil-exporting Arab countries and though Jordan itself had no oil, it benefited tremendously from the economic changes in the region. Foreign aid to Jordan, especially from Saudi Arabia, increased dramatically. In 1975, foreign aid had come to represent 40 percent of Jordan's GDP – up from 22 percent in the 1960s.[115] Between 1973 and 1980, foreign assistance accounted for almost 55% of government revenue.[116] In 1979 alone, Jordan received \$1.32 billion[117] in gross aid while its current revenue was equivalent to only \$711 million.[118]

The price of phosphates, Jordan's main resource export, also increased in the early 1970s and by 1975 phosphate exports constituted more than 16 percent of the country's GDP.[119] The foreign aid and the capital from phosphate exports flowed directly into government coffers and enabled Jordan to go on a decade long spending spree that substantially increased the size of the state in terms of both employment and the provision of generous social services.

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114 Warwick Knowles, *Jordan Since 1989: A Study in Political Economy*, (IB Tauris & Co. Ltd., London, 2005), pg. 48.
115 Moore (2004) p. 103.
116 Rex Brynen, "Economic Crisis and Post-Rentier Democratization in the Arab World: The Case of Jordan," *Canadian Journal of Political Science* XXV:1 (March, 1992) p. 79. Taken from IMF Balance of Payments Statistics from various years.
117 Knowles (2005) pg. 34.
118 World Development Indicators (WDI) CD-Rom, World Bank, February 1997.
119 Moore (2004) pg. 103-104.

The regional oil boom also created a big demand for skilled labor in the neighboring Arab countries and much of this demand was filled by Jordanians. An estimated one-third of the Jordanian workforce was working outside of the kingdom by the end of the 1970s and the remittances that Jordanian workers sent back to family members still in Jordan jumped from almost nothing in the late 1960s to a billion dollars in 1982.[120] In 1984, a year in which total GDP was only $4.9 billion,[121] $1.2 billion entered the country in the form of remittances.[122] A large portion of this capital flowed into private hands and allowed for the rapid expansion of consumer spending. The additional private and public spending during the mid to late 1970s and early 1980s led to high rates of growth and the disappearance of unemployment. While a relatively small amount of the money was invested in the productive sector, the service sector increased dramatically and the country witnessed a construction boom, with a subsequent rise in real estate prices.

Because so many resources were coming from external sources, Jordan was able to finance chronic trade and budget deficits (in 1980 Jordan's trade deficit was over $1.5 billion and its budget deficit was over $300 million)[123] as well as provide generous governmental services without having to extract resources from its own citizenry. Taxation during this period typically financed only 10 to 20% of state expenditures and

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[120] Ibid. pg 16, statistics taken from Central Bank of Jordan, *Yearly Statistical Series (1964 – 1993),* (Central Bank of Jordan, Amman, 1994); International Monetary Fund, International Financial Statistics Yearbook (various years); World Bank, *World Tables 1995* (John Hopkins University Press, Baltimore, 1995).
[121] World Bank WDI (Feb. 1997).
[122] Moore (2004) pg. 16.
[123] Ibid.

import duties another 20 to 30% while the state was able to distribute benefits to tribal leaders, subsidies to agricultural capitalists (mostly of East Bank origin) and business entrepreneurs (predominantly Palestinian), while at the same time establish and maintain extensive health and education programs for the citizenry at large, subsidize many of their basic consumer goods and provide state employment for nearly half of the labor force (three-quarters of East Bankers worked for the state) without maintaining a productive economy[124] or having to incur crippling debts. In 1984 only 4.9% of Jordan's GDP came from agriculture and only 11.9% came from manufacturing.[125]

Governmental attempts to get Jordan's commercial banks to lend more toward productive activities were unsuccessful and commercial lending remained biased toward the trade sector with industrial lending moving up only slightly.[126] Part of the failure was that the policy was more aimed at incorporating Transjordanians into the private economic elite (as a contrast to the Palestinian dominated business elite) than actually bringing about industrialization. With little movement on the level of industrialization, merchants involved in the importation of consumer goods grew wealthy and banks grew much bigger as they financed consumer purchases and construction.[127] In Jordan, and in other neighboring countries, Islamic banks were established for the first time and they grew rapidly in their early years as they provided an Islamically-permissible means for pious Muslims to participate in the formal banking system.

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124 Brynen, p. 79-83.

125 "Jordan at a Glance," World Development Indicators CD-Rom, Feb. 1997.

126 Moore (2004) pg. 106-107.

127 Robins (2004) pg. 146.

FALL OF OIL PRICES AND THE JORDANIAN RECESSION

The interplay between politics and economics has been starkly apparent in Jordan since the mid-1980s as economic realities have forced major political transformations, most notably toward greater liberalization, and as political events such as the Palestinian Intifadha and subsequent events in the occupied territories, wars in Iraq and their direct and indirect effects on Jordan, and the Arab-Israeli peace process and Jordan's role in it have all had important repercussions on economic activity in the country. While Jordan was long able to use politically-inspired economic rents to mask economic problems and delay needed economic reform, the recession of the 1980s and 1990s signaled that with the increasing globalization of capital, Jordan could find it more difficult to avoid the problems caused by an economic system that was not able to generate adequate capital on its own. As in earlier crises, Jordan ultimately leveraged its geostrategic position to accrue external sources of revenue that enabled it to get out of its recession.[128] Since the turn of the century Jordan's economy has again started growing rapidly but that growth is more due to politics and regional political developments than economic development or reform.

While throughout its history until the mid-1980s, rents enabled Jordan to live beyond its means, the economy remained highly vulnerable to the external political and economic environment. When changes began taking places in that environment, Jordan suffered. The dramatic fall in oil prices in the mid-1980s led to a sharp decline in the aid provided to Jordan from the petroleum-exporting states while it also led to the return of

[128] Jay Solomon, "Trouble Next Door: In Jordan, Bombs Highlight Changes Wrought by War," *The Wall Street Journal*, Nov. 10, 2005, pg. A1.

growing numbers of expatriate workers. From the high of $1.32 billion in grants in 1979, Jordan received only $286 million in 1989.[129] Remittances that had accounted for more than $1.2 billion dollars in 1984 had dropped to $623 million by 1989[130] while at the same time current state expenditures increased from JD305 million in 1980 to JD713 million in 1989 leading to a growing deficit and a total external debt that had increased from $2 billion in 1980 to $7.2 billion by 1989, making debt almost twice the value of total GDP which was $4.1 billion that year.[131] The interest payments on the growing debt cost the Jordanian economy $407 million in 1988[132] putting the country further in the red. To make the interest payments, the Jordanian Central Bank drew on its foreign currency reserves which dipped to dangerously low levels.[133]

Meanwhile the Intifadha that had broken out in Dec. 1987 in the occupied Palestinian territories exacerbated tensions between King Hussein of Jordan and the PLO. King Hussein's longstanding contention that the West Bank was an integral part of Jordan became increasingly untenable and in July of 1988, Hussein proclaimed Jordan's total legal and administrative disengagement from the West Bank. While politically most Palestinians welcomed the proclamation, it did lead to considerable anxiety among them regarding their status as citizens in Jordan. Palestinian individuals as well as organizations subsequently withdrew an estimated $200 to $300 million in Jordanian

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129 Knowles (2005) pg 36 and 121.
130 Moore (2004) pg. 16.
131 Ibid.
132 GDF, 1997. P. 288.
133 Moore (2004) pg. 146.

dinars (JDs) from Jordanian banks[134] intensifying the country's financial crisis. Cashing in JDs for dollars combined with the already low foreign currency reserves that had resulted from the last few years of deficit borrowing resulted in a decline of more than 35% in the value of the Jordanian Dinar.[135] The JD fell even further in January 1989 when for the first time in its history Jordan failed to meet its scheduled debt payment.[136] By 1992, the JD was worth only half of its 1987 value.[137]

Prior to the 1980s, the existence of huge rents had enabled the Jordanian monarchy to buy political legitimacy through the distribution of economic benefits without the need for political liberalization. Even throughout most of the 1980s the state attempted to maintain such a system by financing growing budget deficits through domestic borrowing, development loans, or syndicated borrowing on the Euromoney market - thus leading to the huge increase in external debt.[138]

The need to reschedule those debts in early 1989 required Jordan to agree with the IMF on a five-year economic stabilization program that aimed at solving some of the chronic structural problems that outside financial support had previously enabled the regime to ignore. Among other austerity measures, the program entailed sharp reductions in state expenditures including the cutting of subsidies on a number of basic goods, which led to sharp price increases for bread, rice, milk and fuel. As a response, massive

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[134] Ibid. pg. 147.
[135] Laurie Brand, "Economic and Political Liberalization in a Rentier Economy: The Case of The Hashemite Kingdom of Jordan," from ed. Harik, Ilya and Sullivan, Denis *Privatization and Liberalization in the Middle East*, (Indiana Univ. Press, 1992) p. 183-184.
[136] Ibid. p. 180.
[137] WDI, Feb. 1997
[138] Brynen, p. 86.

demonstrations broke out throughout the country in April, 1989. For the first time in Jordan's history, riots had economic rather than political roots and, even more importantly, were led and almost exclusively undertaken by the East Bank Jordanian tribal and agricultural communities as it was this community that was most detrimentally affected by the inability of the regime to maintain its extensive patronage network.

EXPERIMENT IN POLITICAL LIBERALIZATION

The monarchy has always depended on the strong support of the East Bank Jordanians as against the Palestinian refugees and their descendants, who constitute a majority of the country's overall population but have historically had tense relations with the king. Discontent within the tribal communities was seen as a direct threat to the viability of the monarchy that could not be suppressed through coercive measures. The king thus either had to halt the austerity program (a financial impossibility) or seek legitimacy from a broader stratum of the population in ways other than he had in the past. The king opted for a program of political liberalization that he hoped would make the extraction of financial resources from the citizenry more legitimate. Within six months the country had its first parliamentary elections in more than three decades and by far the freest and fairest ever held in the kingdom. Subsequently martial law, which had also been imposed for two decades, was lifted, political parties were allowed to form, and the media was given more freedom than it had enjoyed in the past. Jordanians increasingly felt that the government was accountable and the regime was able to continue with economic austerity measures without incurring the same resistance.

Less than a year after Jordan's parliamentary elections, Iraq invaded Kuwait beginning a series of events that culminated in an American-led war followed by a decade of economic sanctions and then another American-led war and sustained occupation of Iraq. The conflict in Iraq has had a profound economic effect on Jordan. During the 1990-91 war, Jordan lost its main export markets in Iraq, Kuwait, and Saudi Arabia, while tourism and transit trade dwindled.[139] Even more significantly, due to the political liberalization that had recently taken place, King Hussein had no choice but to go along with the overwhelming sentiment within the country and oppose American intervention in the war. As a result, the Gulf States halted what was left of the aid that they had been giving to the country and sent back over 300,000 Jordanian expatriate workers, substantially cutting the already reduced remittances Jordan had been getting from workers in the region. Remittances dropped from $623 million in 1989 to $500 million in 1990 and $450 million in 1991.[140] The financial costs for Jordan in the immediate 12 months following the outbreak of war were estimated at $1.2 billion by the World Bank and at $2.1 billion by the Jordanian Minister of Finance.[141]

At the time, the longer-term effects seemed even more serious as Jordan appeared unlikely to regain the favor of the Gulf States, which had previously played such a large role in providing it with the rents that had enabled it to maintain its warped economic

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139 Economist, "On its Uppers: Jordan," Oct. 5, 1991, p. 50.

140 Moore (2004) pg. 16. Moore bases his figures on World Bank tables but acknowledges that accurately measuring remittances is difficult. He believes that the actual losses could even be more substantial (page 160).

141 Knowles (2005) pg. 81. For an analysis of the costs of the war for Jordan slso see, Timothy J. Piro, "Walking On A Tightrope: Jordan's Economic Balancing Act," *Middle East Insight*, May-June, 1994, p. 35.

structure. The hundreds of thousands of people expelled from Kuwait and Saudi Arabia were putting further strains on Jordan's already overburdened labor market in which more than a quarter of the population was unemployed in 1990.[142]

Throughout the 1990s, international sanctions were imposed on Iraq in a manner that further isolated Jordan. In the decade before the beginning of hostilities in 1990, Iraq had become Jordan's largest trading partner with 40 percent of Jordanian manufactured exports going to Iraq and approximately 250 Jordanian companies established specifically for the Iraqi market.[143] These strong ties can partly explain why Jordanian businessmen were strong supporters of King Hussein's opposition to the American intervention in the region despite the effect it had on Jordan's relations with the Arab Gulf States.[144]

REGAINING EXTERNAL ASSISTANCE AT THE COST OF POLITICAL LIBERALIZATION

The bleak economic situation faced by Jordan in the early 1990s led the monarchy to again seek redress through outside rents in the form of the kinds of external assistance that had largely sustained Jordan since its founding. Gaining those rents would require Jordan to win back U.S. financial and political support and to do that the monarchy was willing to take unpopular political decisions that would require it to reverse many of the political reforms that had recently been enacted. Jordan's geographic position gave it

142 David Gardner, "Hopes are Pinned on Peace," *Financial Times*, Oct. 25, 1995, p. 28
143 Katherine Carroll, Business as Usual? Economic Reform in Jordan, (Lexington Books, Lanham Maryland, 2003) pg. 62.
144 Ibid.

importance with respect to both the situation in Iraq and the Middle East peace process. Jordan was able to capitalize on both to regain American favor and aid, becoming the fourth largest recipient of American assistance in the world by the early part of the new century.[145]

King Hussein made the decision to embrace the Arab-Israeli peace process and go so far as to sign a peace treaty with Israel in 1994. Facing bleak financial and economic prospects in the early 1990s, King Hussein hoped that the normalization of ties with Israel would provide a huge "peace dividend" in the form of increased US aid, a resurgence of tourism and investment as well as increased trade and economic cooperation directly with Israel and, even more importantly, with the West Bank—an area that had constituted a vital part of Jordan's economy prior to its occupation in 1967.

Embracing the peace process against popular discontent with its provisions required the monarchy to curb some of the democratic freedoms that had just been instituted. To thwart opposition to the normalization of ties with Israel, King Hussein decreed stifling new press laws, changed the electoral system to favor tribal elements and curtail the power of large parties, and reinstituted former practices of harassing and jailing opposition elements. These measures led all the major opposition parties to boycott the 1997 parliamentary elections and the democratization process that had begun as a response to an economic crisis less than a decade previously quickly stalled as the king pursued a different political path that he hoped would lead to economic recovery.

[145] The Economist, "Caught in the Middle as Usual," (Economist, Nov. 12, 2005), Vol. 377, issue 8452, pg. 47.

The decision to win back American aid helped the Jordanian economy but did not solve all of its problems. The US forgave $700 million of Jordanian debt as a direct result of the 1994 peace treaty with Israel[146] and did resume aid payments to the country as did some other European countries. However the aid Jordan received from the United States in the late 1990s was modest and did not approach the amount of aid the country had been receiving in the late 1970s and early 1980s from the petroleum-exporting states. The year before signing the peace treaty, Jordan received $201 million in grants.[147] Those figures increased to $436 million in 1994, largely as a result of the peace treaty, but decreased to $311 million in 1996, less than one-fourth of the $1.32 billion Jordan had received in 1979.[148]

While increased trade also helped the economy, it also did not reach the levels that had been hoped for. Trade with Israel and the West Bank, what many in Jordan had hoped would be one of the main benefits of peace, never materialized. Jordanian industry is tailor-made to meet many of the Palestinians' needs for medium technology goods and textiles as well as construction material like cement, iron bars, and ceramic tiles but as such it posed a threat to Israel's total control over the captive $2 billion Palestinian market and Israel imposed draconian measures that made it practically impossible for Jordanian traders to infiltrate the occupied territories.[149]

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[146] Kirk Albrecht, "The Pains of Restructuring," *Middle East*, Oct. 1996, n260, p. 21.
[147] Knowles (2005) pg. 121.
[148] Ibid., pg. 36.
[149] Albrecht, p. 22.

Population growth outpaced growth in the size of the economy during the late 1990s.[150] With a continued decline in consumption caused by IMF-imposed austerity measures, a slow-down in real estate investment that had dramatically increased after the Gulf War in the early 1990s when expatriates returned to the country, stagnant Iraqi and Palestinian markets, as well as the lack of any peace dividend, Jordan experienced an economic growth rate of only .8% in 1996. While population growth rates were above 3% annually, economic growth was only 2.2% in both 1997 and 1998 and then dipped to 1.8% in 1999.[151]

The economic pressures led King Hussein to work hard to re-establish ties with the Gulf States even at the expense of Jordan's relations with Iraq. In the late 1990s, Jordan allowed Iraqi opposition groups to set up bases in Amman and after King Hussein's death in 1999, his successor King Abdullah was able to fully restore relations with all the Gulf States. As American preparations to invade Iraq began after September 11, 2001 and then through the war and sustained occupation, King Abdullah backed the Americans. The renewed relationship with the Gulf States enabled hundreds of thousands of Jordanians to return to employment in the Gulf and by 2002 remittances into Jordan reached approximately $2.3 billion.[152] Despite the economic benefits Jordan has received from its position toward the Iraq war, the decision remains deeply unpopular among the Jordanian population and to maintain it the Jordanian regime has further

[150] Carroll (2003) pg. 96 with statistics taken from the Central Bank of Jordan.
[151] Ibid.
[152] Knowles (2005) pg. 87.

clamped down on political and civil liberties and has increased the pervasive role of the security services.[153]

After the turn of the century, Jordan was able to pull out of its recession but the economic growth it has witnessed over the past few years has more to do with regional events than on changes in the economic structure of the country. After Jordan's siding with the United States in the aftermath of the events of September 11, 2001, especially regarding the American war against Iraq, aid levels shot up to $542 million in 2002 and since then Jordan has remained the fourth largest recipient of American aid in the world (after Israel, Egypt, and Columbia). Jordan's regional stances also helped it conclude important trade agreements with the United States and Europe. Jordan signed an Association Agreement with the EU in 1997 and joined the World Trade Organization in 1999. In 2000, it signed a Free Trade Agreement with the United States, joining Canada, Mexico and Israel as the only other countries in the world with such a privileged trade status.[154]

Not only did American aid and trade increase, but unlike the 1990-91 war which had a profound negative impact on the Jordanian economy, the 2003 war has had a positive impact. Hundreds of thousands of Iraqis flooded into Jordan in the aftermath of the war, including much of the Iraqi economic elite who have invested substantially in the kingdom.[155] The infusion of investment capital from Iraqis as well as Jordanians working in the Gulf who have benefited from the steep rise in the price of oil that came

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153 Julia Choucair, "Illusive Reform: Jordan's Stubborn Stability," (Carnegie Endowment for International Peace: Carnegie Papers Middle East Series, Number 76, Dec. 2006).
154 Robins (2004), pg. 184.
155 Solomon (*The Wall Street Journal*, Nov. 10, 2005) pg. A1.

about largely as a result of the Iraqi war helped stimulate high growth rates that in addition to American aid and increased international trade helped pull Jordan out of its recession.

JORDAN'S FINANCIAL SECTOR

Even though Jordan was ultimately saved from economic collapse by its ability to again trade in its geostrategic position for various forms of rent, more than a decade of economic hardships convinced many in the Jordanian elite that economic reform cannot be put off forever and that the Jordanian economy must find a way of standing on its own to weather future crises. During the recessions of the 1980s and 1990s, the Jordanian regime was forced to work on restructuring some aspects of its economy and economic reform has been declared the top priority of the country since Abdullah became King in 1999. While they were not enough to make Jordan self-sufficient, the reforms that did take place during the late 1990s and early part of the century were in some senses successful.

Restructuring programs helped Jordan bring inflation down from approximately 25% in 1989 to less than 2% in 2001[156] and the Jordanian Central Bank was able to build up enough foreign-currency reserves to cover five months of imports while food subsidies were abolished, even in the face of violent riots.[157] Jordan has worked to increase domestic savings and attract private sector investment and part of the success in

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[156] Speech of King Abdullah at Harvard University printed in as "Heir Jordan: One State's Story of Economic Transformation," *Harvard International Review*, Vol. 24 (4), Winter 2003.
[157] Economist, "The Smile Fades: Jordan," July 4, 1998, p. 40-42.

this area is what made Jordan an attractive market for the Iraqi capital fleeing Baghdad. In this era of economic globalization, attracting such investment and even increasing domestic savings depends a great deal on Jordan's financial system and financial sector liberalization has been one of the most important aspects of Jordan's economic reform programs. The manner in which future financial sector reform takes place is likely to constitute an increasingly important variable in explaining the future political development of the country.

Commercial banks remain the principal allocators of finance capital in Jordan but the stock market, which enjoyed phenomenal growth in 1992 and 1993 and then again between 2003 and 2005, has become an important secondary source. There are a total of 23 local commercial and investment banks in Jordan.[158] The sector remains dominated by the Arab Bank but the extent of that dominance is hard to calculate accurately since in its consolidated banking reports, the Central Bank of Jordan does not list the statistics of individual banks and the banks themselves are not required to publish reports that distinguish between their branch activities inside and outside of Jordan.

The Arab Bank and a number of other Jordanian banks have foreign branches and in their published annual reports they do not always distinguish between their domestic and foreign activities. Thus while some analysts go so far as to claim that the Arab Bank commands about 60% of overall customer deposits, net credit facilities and net

[158] A list of the banks is published by the Association of Banks in Jordan (ABJ) and can be found at http://www.abj.org.jo. The same list is also found on the website of the Central Bank of Jordan at http://www.cbj.gov.jo. 299.

shareholders equity in the country,[159] this is probably overstated since most of the Arab Bank's business is outside of Jordan. In its 2006 annual report, Arab Bank itself only claims to control about 20% - 25% of total assets, deposits, and direct credit facilities inside Jordan.[160] The second largest bank in the country, the Housing Bank, probably commands about 15% of total customer deposits inside the country while the next four largest banks – the Jordan Islamic Bank, the Jordan National Bank, the Cairo-Amman Bank, and the Jordan-Kuwait Bank – each have about 7% - 10% of total deposits inside the country.[161]

In 1997, the Higher Court of Investment removed the 50% foreign ownership restriction on the banks and some other listed stocks. More than 50% of the Arab Bank became owned by foreigners, mostly governments and government agencies of Saudi Arabia, Kuwait, Qatar and Oman.[162] Private Jordanian investors, many of whom are very close to palace circles, also have substantial holdings in the bank but the Arab Bank and Jordanian banks in general are not linked to industrial conglomerates or holding companies as major commercial banks are in financial systems that are based on concentrated oligopolistic commercial banking structures.[163] While the Arab Bank has one of the best reputations in the region and is financially healthy, its foreign ownership

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159 See for example Samer Sunnoqrot, "Commercial Banking in Jordan," from Philip Dew and Jonathan Wallace ed. *Doing Business with Jordan*, (Kogan Page Limited, London, 2004), pg. 299.
160 See *Arab Bank 2006 Annual Report*, pgs. 33 and 34.
161 These estimates are based on the annual reports of the banks and the consolidated banking data from the Central Bank of Jordan.
162 Julian Ozanne, "Bureaucracy Blights Trading," *Financial Times*, Oct. 25, 1995, p. 29.
163 Henry, p. 16.

as well as the lack of stronger economic linkages between the bank and major industrial enterprises weakens the structural power of capital in Jordan.

The Central Bank plays an important role in Jordan though it does not enjoy a large degree of autonomy vis-a-vis the government. To maintain the strength of the Jordanian Dinar, to encourage JD over foreign denominated deposits, to prevent capital flight and even encourage the repatriation of some of the estimated \$5-6 billion in Jordanian capital held abroad, the Central Bank maintained tight monetary policies with high interest rates throughout the 1990s bringing a lot of money into the banking sector but squeezing banking profits.[164]

Stung by the failure of Petra Bank in 1987 and the more general banking crisis of 1989, the Central Bank tried to encourage mergers among the smaller Jordanian banks throughout the 1990s and 2000s, but with very limited success.[165] While some banks have merged, new ones have also been established. New banking laws passed in 1998 further strengthened incentives for mergers while also increasing overall transparency in the sector. The laws were intended to strengthen the banking sector and provide it with the means to capitalize on new trade and investment opportunities expected to materialize with Jordan's entrance into the World Trade Organization and its trade agreements with the European Union and the United States.

While a strong banking sector can help Jordan avoid capital flight and perhaps even bring in some of the capital that has already left the country, increased foreign

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[164] Ozanne, "Pushing for Mergers," *Financial Times*, Oct. 25, 1995, p. 28.
[165] Ibid., and Sunnuqrot (2004) pg. 301.

investments depend more on stock markets than banking. The Jordanian stock market witnessed a boom from 1991 to 1993 and then again from 2003 to 2005. In the early 1990s, the all-share index on the Amman Financial Market climbed 100 per cent in three years, turnover tripled from JD302 million in 1991 to JD969 million in 1993,[166] and market capitalization rose above $5 billion.[167] While the boom gained the attention of foreign investors, it was not led by them and in fact bureaucratic obstacles limited the amount that could have been brought in by external sources. The boom was largely the result of the temporary infusion of cash that came into Jordan with the more than 300,000 expatriate workers that were expelled from the Gulf after Iraq's invasion of Kuwait and brought an estimated $1.5 billion in foreign currency with them to Jordan.[168]

The rapid growth of the stock market led to some anxiety and in July 1993 the Central Bank intervened with measures to deter local speculators from buying stocks with borrowed funds. As a result, annual turnover dropped by 40% while price/earnings ratios declined from 25 times to a more modest but still attractive 16.5 times income.[169] The market then fell into a prolonged slump with continued growth impeded by bureaucratic and political obstruction. Reforms in the late 1990s again made the stock market (renamed the Amman Stock Exchange in 1999 as part of the reforms)[170] attractive and it witnessed another boom from 2003 to 2005 largely fueled by the infusion of Iraqi capital into the country.

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166 Ozanne, Bureaucracy, p. 29.
167 Andrew Album, "Stock Market Review: Jordan," *The Middle East*, Feb. 1998, p. 43.
168 Peter Cowan, "Jordan: Boom or Blip?," *The Middle East*, Sept. 1994, p. 29.
169 Ibid.
170 Jamil Tarif, "Amman Stock Exchange," from Philip Dew and Jonathan Wallace ed. Doing Business with Jordan, (Kogan Page Limited, London, 2004), pgs 313-314.

Until 1995, foreign investors in Jordan were required to get government approval and between 1993 and 1995 when 56 foreign funds applied to invest $450 million in the stock market, the government only approved $200 million after lengthy delays that irritated investors.[171] The stock market was also weakened by tight monetary policies that provided incentives for local investors to put their money in fixed interest securities.

A number of reforms that began in 1997 increased interest in the stock market. In addition to scrapping the 50% foreign ownership restrictions on banking and insurance stocks, the Central Bank cut interest rates for the first time in eight years and lifted foreign currency controls that had been imposed since 1989.[172] The Jordan Securities Commission was also established and soon issued wide ranging financial disclosure rules that assured greater transparency. Such reforms led to increased interest in the stock market. Total trading for 1997 reached JD355 million which represented a 43% increase over 1996 even if it was still far below the 1993 high.[173] The general slump however continued as more laws and regulations were passed to attract foreign investment, including serious movements toward privatization of state-owned enterprises.[174]

The reforms ultimately proved successful and the boom that began in 2003 was even greater than the one of the early 1990s. Stock market capitalization tripled in just two years to reach over $37 billion by 2005.[175] In 2005, stock market capitalization

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[171] Ozanne, Bureaucracy, p. 29.
[172] Album, p. 42.
[173] Dougherty, p. 10.
[174] Pam Dougherty, "Cement Sale Fiasco Masks Progress on Privatization," *Middle East Economic Digest*, May 1, 1998, p. 2.
[175] Solomon (2005). Also see historical statistics on the Amman Stock Exchange website located at: www.ammanstockex.com.

represented more than 325% of Jordan's GDP. Since the high of 2005, the stock market has retreated. Stock market capitalization in May of 2007 was approximately $32 billion representing about 225% of Jordan's GDP.[176] Much of the boom was generated from foreign investment as indicated by the fact that non-Jordanian ownership of market capitalization increased from 37% in 2002 to 45% in 2005. During the retreat in the market from 2005 to 2007, non-Jordanian ownership slightly increased to 46% of overall capitalization. The reforms of the late 1990s and early 2000s made Jordan an attractive area for investment and perfectly placed to capitalize on the billions of dollars that have fled Iraq since the outbreak of war in 2003.

JORDAN'S FUTURE POLITICAL-ECONOMY

The banking and stock market reforms that began in 1997 were a direct result of the increasingly dire state of the Jordanian economy. Since Abdullah became king in 1999, economic reform has continued at an even faster pace as the new monarch has put an emphasis on the economy that did not exist during his father's reign. However, regional political events and the resumption of large amounts of rent – and not any underlying structural reforms - ultimately saved the Jordanian economy. Jordan remains highly dependent on rents. While aid has not regained the level of the late 1970s and early 1980s, by 2007, Jordan was receiving in excess of $500 million in annual aid and the amount that Jordan received from remittances was well over $2 billion a year, much

[176] Statistics from www.ammanstockex.com.

higher than it was even during the peak oil boom years of the late 1970s and early 1980s.[177]

This continued rent will depend on political developments in the region, regarding the war in Iraq, the Middle East peace process, and the impact the Arab Spring of 2011 has on Jordan. The policies of the Jordanian government regarding Iraq and the Middle East peace process are deeply unpopular and to maintain them the regime has significantly reversed the political reforms of the late 1980s and early 1990s.[178] While the popular revolts that occurred in neighboring Arab countries in the first half of 2011 have not yet been replicated on a large scale in Jordan, the regional developments threaten to spill over into Jordan making the country vulnerable at a time when its king does not have the legitimacy that his father enjoyed. Jordanian support for the U.S. war on Iraq was deeply unpopular across the Jordanian political spectrum and Jordan's vulnerabilities in this respect were underscored by the November 9, 2005 attacks on Jordanian hotels that were masterminded by a Jordanian citizen who was at the time leading the most violent of all the Iraqi resistance groups.[179]

Jordan's peace treaty with Israel is also unpopular, especially as the situation inside the occupied territories has deteriorated and Israel is not seen to be serious about making any substantial concessions toward the Palestinians. Throughout the late 1990s, anti-normalization activities by Jordanian professional associations and political parties were often interpreted as direct attacks against the state and resulted in arrests and new

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[177] Knowles (2005), pg. 88-89.
[178] Choucair (Dec. 2006).
[179] Solomon (Nov. 2005).

political restrictions. The overwhelming victory by Hamas Islamists in Palestinian legislative elections in January, 2006 and the subsequent Palestinian Civil War in the summer of 2007 between the Palestine Liberation Organization nationalists and the Hamas Islamists – who have close ties to the Jordanian Muslim Brotherhood – have increased Jordan's vulnerabilities.[180] The unstable regional environment regarding both Iraq and the occupied Palestinian territories has increased the risk that Jordan could again face an internal crisis on the proportions of the mid-1950s or early 1970s.

These unpopular regional stances are being adopted at the same time that the Bedouin tribes and the Muslim Brotherhood - the two population segments that historically supported the regime in times of real crises – are now more alienated than ever from the monarchy. The economic reform measures that began in 1989 and were later accelerated by King Abdullah undermined the bedrock support the monarchy has traditionally enjoyed in tribal communities. This is best symbolized by the violent riots that broke out in 1996 when bread prices doubled. As in 1989, these riots took place in purely tribal areas. However, unlike the 1989 riots that led to political liberalization and electoral laws that clearly favored tribal elements, the 1996 riots were followed by further repression and underscored the failure of the liberalization experiment to guarantee political stability. Subsequent political events and the resumption of large rents enabled Jordan to weather the crisis but the monarchy is now more dependent than ever on outside support.

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[180] Choucair (Dec. 2006).

When riots again broke out in 2011, the king replaced a prime minister who was from a prominent Palestinian family with Marouf Bakhit, a military man from a prominent Jordanian tribe. The move underscored King Abdullah's fear of losing tribal support. The announcement by the Gulf Cooperation Council in May, 2011 that it was inviting Jordan to become a member of the council was perceived as an attempt by Saudi Arabia to shore up the regional monarchies in the face of the pressures emanating from the popular Arab revolutions calling for political reform. Saudi willingness to provide Jordan with substantial amounts of aid may help buy time for the Jordanian Monarchy by providing it with the largesse needed to buy off the tribes but the king's relationship with the political opposition is likely to become more strained as Arab peoples throughout the region increasingly demand democratic reform.

This is especially true of the relationship between the Jordanian regime and the Muslim Brotherhood. The leftist and secular opposition to the Jordanian Monarchy that had been strong in earlier decades was almost non-existent in Jordan by the 1990s thus removing one of the factors that had previously brought the Brotherhood and the regime together. While leftists had historically used their control over the elected boards of the professional associations in Jordan as a means of expressing their opposition to certain governmental actions, by the 1980s Islamists were overwhelmingly elected to lead nearly all the professional association boards. The Brotherhood has demonstrated similar electoral dominance in university student council elections. In the 1989 and subsequent parliamentary elections, the Brotherhood further proved that it was the only organized opposition force that could garner substantial popular support.

The Brotherhood's strong opposition to the peace process with Israel and the 1994 peace treaty led to a crisis in relations between the Brotherhood and the regime. Whereas previously the Brotherhood's position on the West Bank and on the Jordanian monarchy as a whole was able to provide the Jordanian regime with legitimacy in the face of popular opposition, the Brotherhood has now come to represent the only force of real opposition to the regime and its position on the issue that has come to define much of what Jordan represents to the outside world is the main factor that threatens the continued legitimacy of the monarchy. While King Hussein was able to deftly gain the support of the Islamists by providing haven to persecuted Egyptian and Syrian members of the Brotherhood, one of King Abdullah's first acts as a new king in 1999 was expelling from Jordan the political leadership of Hamas, a Palestinian Islamist group with strong ties to the Jordanian Muslim Brotherhood. Since September 11, 2001 and the renewed international attempts to curtail the activities of Islamists, the Brotherhood – despite its moderation and non-violent approach – has come under renewed pressure that threatens its longstanding relationship with the regime.

King Abdullah has sought to strengthen ties with the business community. While political liberalization has been reversed, economic liberalization has picked up pace since Abdullah's accession. Before regional events after September 11, 2001 enabled Jordan to again obtain large rents, King Abdullah had become convinced that the future stability of Jordan depended on adopting the Washington consensus version of economic development and that the successful implementation of such reforms would require the active support of the business community.[181] The king has hosted a number of international conferences with economic reform themes, established and given real power to the Economic Consultative Council, and strongly backed privatization schemes. Abdullah has taken a special interest in promoting certain export sectors, most notably information technology.[182] All of his moves have been undertaken in close cooperation and coordination with Jordan's private sector business elite.

In an earlier era, King Hussein was able to secure regime stability through patronizing the East Bank tribal communities and using the Muslim Brotherhood as a bridge toward other segments of the population, most notably the more activist and urban, lower and middle-class segments of Palestinian origin. As a large organization that was able to cross nearly all socio-economic divides in Jordan, the Brotherhood's support gave legitimacy to the regime during times of crises. Abdullah's strategy of patronizing the wealthier business elite while adopting policies that have alienated the East Bank communities and the Brotherhood is a more insecure policy. While the return of large rents has enabled the monarchy to postpone the question, it remains unclear how stable the regime would be in the event of a real crisis.

The remaining portions of this dissertation will explore the potential of Islamic banking to serve as a bridge that can allow Jordan to continue economic reform policies that will bring about the kind of viable economy Abdullah seeks while winning back

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[181] Knowles (2005) pg. 141-142; also see King Abdullah's Harvard speech (Winter 2003).
[182] Knowles (2005) pg. 83.

enough Islamist support to provide the regime with the legitimacy it needs to remain stable.

CHAPTER FOUR: SOCIAL IMPACT OF ISLAMIC BANKING IN JORDAN

Advocates of Islamic Banking are often quick to point out the positive social role such banks play in society. Islamic banks are said to be inherently more just than conventional banks and the growth of Islamic banking is often touted as a means to bring about a greater degree of social justice in society.[183] Islamic banks are viewed as having higher objectives than merely that of being financial intermediaries and theoretically the structure of such banks and the manner by which they finance projects should have a transformative effect on the larger society, helping to lessen inequality, eliminate poverty while at the same time increasing economic development.

Finance is a powerful tool and the presence or lack of institutional structures that facilitate the investing and financing of surplus money can have a profound impact on any society.[184] Islamic banks have played an important social role in Jordan in that they provided such structures to a large segment of the population that had previously kept themselves out of the conventional banking system. The best means of gauging the social role played by Islamic banking in Jordan is to look closely at the annual reports of the Jordan Islamic Bank (JIB) from its inception and analyze the growth trajectory of the bank as well as the manner by which it obtained and used its funds. While the bank has certainly not had the kind of transformative effect on Jordanian society that some of the theoretical advocates of Islamic banking allude to, the JIB was able to quickly become a

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183 M. Umer Chapra, *Islam and the Economic Challenge*, (Leicester: The Islamic Foundation, 1992); Munawar Iqbal ed., *Islamic Economic Institutions and the Elimination of Poverty*, (Leicester: The Islamic Foundation, 2002).

184 Scott MacDonald and Albert Gastman, *A History of Credit & Power in the Western World*, (New Brunswick: Transaction Publishers, 2001).

major financial player in Jordan that has had a meaningful impact on various facets of the country. While the focus of this chapter will be to provide a detailed analysis of JIB, some allusions will also be made to the Islamic International Islamic Bank.

ANALYSIS OF JIB ANNUAL REPORTS

Table 4.1 shows the total assets of the Jordan Islamic Bank (JIB) from its founding in 1979 through 2006. The table underscores the tremendous growth rate that the bank has experienced. Starting out with slightly more than JD7 million in 1979, the bank had over JD1.7 billion in assets by the end of 2006. The growth during the first two years of operations, 112% and 104% respectively, underscored the wide acceptance and demand for Islamic banking in the Jordanian market.

Table 4.1: Total Assets of the Jordan Islamic Bank (1979 - 2006)

Year	Total Assets (millions of JD)	Growth Rate %
1979	7.3	
1980	15.5	112
1981	31.6	104
1982	45.2	43
1983	71.5	58
1984	102.1	43
1985	126.8	24
1986	161.7	28
1987	197.4	22
1988	222.6	13
1989	242.3	9
1990	244.8	1
1991	356.8	46
1992	435.3	22

Year	Total Assets (millions of JD)	Growth Rate %
1993	528.3	21
1994	570.0	8
1995	621.9	9
1996	618.7	-1
1997	650.6	5
1998	706.8	9
1999	756.7	7
2000	828.3	9
2001	901.7	9
2002	1029.7	14
2003	1159.2	13
2004	1301.4	12
2005	1568.4	21
2006	1726.0	10

Source: Unless otherwise stated, all the tables in this chapter are based on the annual reports of the Jordan Islamic Bank. Some of the figures for the early years was consolidated from the annual reports by Abdallah al-Maliki in the book, *Al-Bank Al-Islami fi al-Urdun*, (Amman: al-Dustour al-Tijari) 1996.

The bank experienced its most rapid growth in its first five years of operations, during which its annual growth rate was never less than 43%. The bank stabilized somewhat from 1984 to 1988 when its annual growth rate fluctuated between 13% and 24%. During the next two years Jordan was in the midst of a financial crisis and regional events in the West Bank as well as the feelings of instability that resulted from the Gulf War led many depositors to withdraw their money from all Jordanian banks. JIB's annual rate of growth fell to 9% in 1989 and only 1% in 1990. With the conclusion of the crisis, JIB's growth skyrocketed by 46% in 1991 making up for the two years of relatively slow growth and the bank continued experiencing rapid growth for the next two years. In 1994 and 1995, the annual growth rate fell to 8% and 9% annually and then in 1996 the bank lost 1% in total assets, the only year in which JIB experienced a negative growth rate. Jordan as a whole was in a deep recession at the time. For the next five years, the bank grew by less than 10% annually and then from 2002 until 2006 the bank's annual growth rate increased to between 10% and 21% annually.

According to the Central Bank of Jordan, there was a total of JD24.2 billion in total assets of licensed banks in Jordan at the end of 2006[185] making the JIB's JD1,726 million equivalent to 7.1% of the total assets of all licensed banks in the country. It is difficult to compare the size of JIB to other banks in Jordan since the Central Bank does not list the assets that individual banks have in Jordan and the banks themselves are not

[185] The annual reports of the Central Bank of Jordan can be found at http://www.cbj.gov.jo

required to publish reports that distinguish between their assets inside Jordan and outside the country.

Adding up the figures as reported in the annual reports from just the 13 Jordanian banks (not including the branches of the 8 foreign banks with branches in Jordan), shows JD39 billion in total assets in 2006 while the Central Bank reported that the banks only had JD24.2 billion[186] of assets in Jordan. The huge discrepancy can be explained by the fact that the banks' reports count assets inside as well as outside of the country while the Central Bank only counts those inside Jordan. Since JIB does not have any branches outside of the country the vast majority of their assets are domestic and thus the 7.1% of total assets in Jordan is accurate. This would make JIB the third largest bank in terms of total assets inside Jordan, behind the Arab Bank and the Housing Bank. Two banks that report slightly more assets than JIB, Jordan Ahli (National Bank) and the Jordan-Kuwait Bank, both have a number of branches outside of the country. This analysis is also in line with the IBIS data used to make Table 2.1 which showed that JIB's percentage of total assets fluctuated between 6% and 8% between the 1990s and early part of the new century while the Islamic International Arab Bank (IIAB) had garnered about 2.5% of the overall Jordanian market in 2003 with both Islamic banks thus accounting for about 10% of overall banking assets in the country.

While it is not possible with the current data to categorically state that the phenomenal growth of Islamic banking in Jordan has resulted more in an increasing

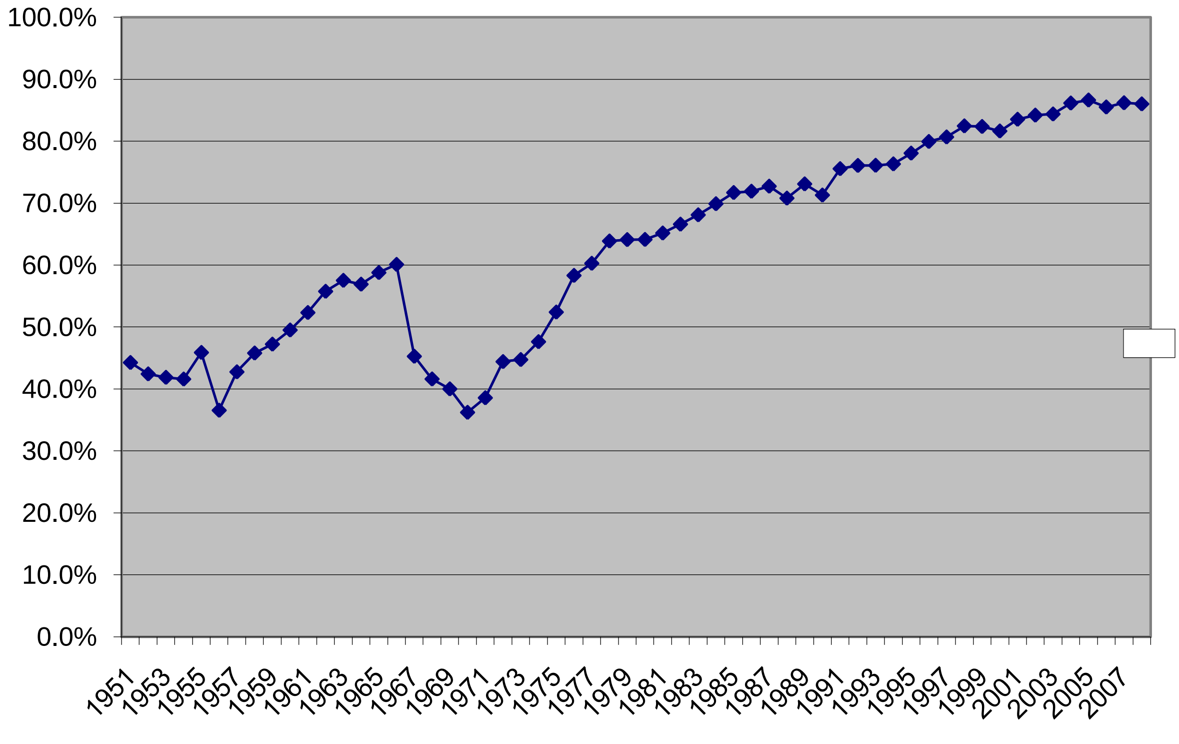
[186] The Central Bank website lists all the banks that are licensed in Jordan and provides links to the web sites of the banks, all of which have annual reports.

number of people participating in finance (rather than just switching from conventional to Islamic banks), the gradual but consistent increase in the overall ratio of Jordanian money that is held within the Jordanian banking system along with both the rapid growth of JIB and later IIAB while the other major banks in the country (most notably Arab Bank and the Housing Bank) have not reported concomitant declines seems to indicate that at least part of the story explaining the growth of Islamic banking in the country is the increasing number of people willing to put their money in an Islamic Bank while they had previously kept their cash out of the banking system altogether.

Chart 4.1 depicts the Contract Intensive Money ratio (the ratio of money held inside the banking system to the overall money supply) in Jordan from 1951 to 2008.[187] The chart shows that Jordan has progressed from having a very low CIM ratio of less than 45% in 1951 to much more respectable level of more than 85% where the growth in the CIM ratio seems to have stabilized since 2004.

[187] For an explanation of the importance of CIM ratios as a measure of the institutional credibility of a country see Clement Henry and Robert Springborg, *Globalization and the Politics of Development in the Middle East*, (New York: Cambridge Univ. Press, 2010), 79-82.The data for chart 4.1 comes from Clement Henry who calculated it using IMF statistics for all Middle Eastern countries partly for the analysis made in the book.

CHART 4.1: CIM in Jordan 1951-2008



Source: This chart was calculated by Dr. Clement Henry using IMF International Financial Statistics.

The CIM ratio in Jordan increased gradually through the years with major declines during periods of particular political turbulence – first in the late 1950s around the time that the attempted military coup against King Hussein took place and then an even greater decline during the turbulence between the 1967 war and the 1970 Jordanian Civil War. A smaller decline took place in the late 1980s when - as mentioned above - Jordan was in the midst of a financial crisis and regional events in the West Bank and Iraq led many depositors to withdraw their money from the banking system.

From a low point in 1970 when only 36% of Jordanian money was held in the banking system, the CIM ratio increased at a rapid pace until 1978 when 64% of the Jordanian money supply was held in the banking system. From 1978 until 1980 the ratio stabilized at 64%. It was at that same time that JIB was established. The CIM ratio began another ascent from 1980 until 1987 during which time the ratio increased from 64.1% to 72.7%. It was during this same period of time that JIB experienced its most rapid rate of growth. Based on the overall Jordanian money supply in 1987 (JD2.4 Billion) the difference between 64.1% and 72.7% represented JD864 million. It was also during that time that the overall assets of Islamic banking in Jordan increased from nothing to approximately JD200 million. It is reasonable to assume that a large percentage of this JD200 million would have remained out of the banking system and the CIM ratio would not have risen as quickly as it had were it not for the establishment of JIB.

From 1987 until 1990, the CIM ratio in Jordan actually declined. Then from 1990 until 2005 it again experienced steady growth going from 71.3% in 1990 to a high of 86.6% in 2005. Based on the overall Jordanian money supply in 2005 (JD12.4 Billion) the difference between 71.3% and 86.6% represented JD3.6 Billion. It was during this time that the overall assets of Islamic banking in Jordan increased from around JD200 million in 1987 to JD2 Billion in 2005 (JD1.6 Billion in JIB and JD400 Million in IIAB). Again it is reasonable to assume that a large percentage of this additional JD2 Billion would have remained outside of the banking system and the CIM ratio would not have risen so rapidly had it not been for the existence of Islamic Banks.

Another indicator of JIB's rapid rate of growth and the demand for Islamic banking that it fulfilled can be seen in Table 4.2 which shows the amount, kinds, and growth of deposits in JIB from its founding in 1979 up through 2006. In its first year of operations, JIB was able to attract about JD5 million in deposits. Ten years later, the bank had JD211 million and in another ten years it had nearly JD650 million. By the end of 2006, it had over JD1.5 billion in deposits of various kinds.

The fastest growth took place during the first ten years (1979 – 1989) of the banks existence in which there was only one year (1988) in which the average annual rate of growth in deposits was less than 20%. The financial crisis that Jordan experienced in 1989 and 1990 led to a year of negative growth in 1990 but JIB quickly rebounded with two more years of very high growth. The next year (1993) total deposits in JIB grew by 14% and then for the next six years the rate of growth was less than 10% annually. The rate of growth picked up after that, growing by between 12% and 19% annually from 2000 until 2005 – the same time that it was competing for deposits with Jordan's other Islamic bank, the Islamic International Arab Bank, which opened in 1998.

Table 4.2 also shows the size of the different kinds of deposits that are made in JIB. The main division is between deposits that are placed in the bank by other banks and the deposits that are placed by individuals or companies.

Table 4.2: Deposits in Jordan Islamic Bank (1979 – 2006)

(Millions of JD)

Year	From Banks	Individual Deposits (4 kinds)	1. Specific Invest. Accounts	2 Mqrda Bonds	3 Trust Accounts		4 Joint Investment Accounts					Total Deposits	
					Value	% Growth Rate	Total Value	Total % Growth	Saving	Fixed	Notice	Value	% Growth Rate
1979	0.01	4.9	1.0		2.5		1.4		0.20	1.20		4.9	
1980	0.01	12.5	0.9		4.8	92	6.8	386	1.10	1.59	4.09	12.5	155
1981	0.01	26.2	0.9		12.2	154	13.1	93	1.86	3.23	8.02	26.2	110
1982	0.2	36.8	0.9		16.4	34	19.5	49	3.27	4.65	11.53	37.0	41
1983	0.6	61.4	2.9		20.7	26	37.8	94	4.90	19.45	13.48	62.0	68
1984	0.9	89.5	6.6		22.3	8	60.6	60	6.83	38.71	15.03	90.4	46
1985	0.7	113.5	10.7		23.7	6	79.1	31	8.06	55.18	15.87	114.2	26
1986	0.3	142.6	15.0		26.6	12	101.0	28	10.29	74.35	16.33	142.9	25
1987	2.1	174.4	15.9		31.2	17	127.3	26	12.53	98.28	16.45	176.5	24
1988	3.1	195.0	17.2		35.1	13	142.7	12	14.06	110.26	18.39	198.1	12
1989	4.1	207.0	19.7		43.7	25	143.6	1	16.28	111.04	16.28	211.1	20
1990	4.8	204.6	14.2		38.7	-11	151.7	6	15.34	121.47	14.87	209.4	-1
1991	2.4	313.7	16.7		60.0	55	237.0	56	23.02	195.14	18.79	316.1	51
1992	6.0	387.0	17.7		72.9	22	296.4	25	31.80	239.90	24.72	393.0	24
1993	5.7	442.0	21.4		85.1	17	335.5	13	24.90	275.12	25.46	447.7	14
1994	5.6	477.0	14.8		89.4	5	372.8	11	36.50	309.02	27.25	482.6	8
1995	6.4	521.9	13.4		91.5	2	417.0	12	43.40	344.75	28.84	528.3	9
1996	6.3	518.3	16.0		85.6	-6	416.7	0	38.10	350.12	28.44	524.6	-1
1997	5.3	546.5	25.3	7.8	89.7	5	423.7	2	43.84	354.24	25.56	551.8	5
1998	3.5	593.1	52.0	13	99.4	11	428.4	1	47.74	359.35	21.64	596.6	8
1999	4.2	642.9	82.9	16	101.8	2	441.9	3	54.53	368.78	18.60	647.1	8
2000	4.0	734.1	118.0	52	126.4	24	438.2	-1	62.73	359.34	16.12	738.1	14
2001	4.5	819.4	126.5	71	140.1	11	481.4	10	67.48	395.26	18.69	823.9	12
2002	4.4	943.4	108.2	125	179.5	28	531.1	10	78.72	436.23	16.11	947.8	15
2003	4.5	1060.6	95.2	88	236.8	32	640.2	21	104.20	517.65	18.30	1065.1	12
2004	4.1	1201.6	79.9	101	285.2	20	735.4	15	128.04	584.02	23.30	1205.7	13
2005	47.7	1381.7	66.9	159	351.3	23	804.4	9	148.88	629.09	26.47	1429.4	19
2006	30.7	1490.7	87.3	167	375.4	7	861.3	7	170.80	660.90	29.60	1521.4	6

Throughout JIB's history, the amount deposited in the bank from other banks has always been very low with most of those funds coming from banks outside of Jordan. From 1979 until 2004 the percentage of total deposits in JIB from other banks was never more than 2% [except in one year (1990) when it was only slightly more than 2%], this is in direct contrast to the Islamic International Arab Bank where 40% to 50% of its overall deposits have been from other banks.[188] The deposits in the IIAB from other banks come primarily from the Arab Bank, which exchanges IIAB JD funds for Arab Bank dollars that are then invested in international commodity markets since the IIAB could not find enough investment opportunities inside Jordan that were both prudent and *shari'a* compliant. In 2005, the amount deposited in JIB from other banks jumped more than 11 times from the previous year, going from JD4.1 million in 2004 to more than JD47 million in 2005. This marked the first time that JIB began actively working in the interbank swap market and JD41.7 million of the total bank deposits resulted from swaps.[189]

Individuals can deposit money in JIB in one of four ways, through Specific (Restricted) Investment Accounts, Muqarada Bonds, Trust Accounts, or Joint (Unrestricted) Investment Accounts.

Trust Accounts, which are similar to checking accounts in conventional banks in that depositors who place funds in Trust Accounts get no return on their deposit, made up the majority of individual deposits in JIB's first year of operations with JD2.5 million. They then declined as a percentage of overall deposits until they became less than 20% in 1986 (see Table 4.3) and have remained at about that level with only slight fluctuations since. During the financial and banking crisis of 1990, the amount deposited in JIB Trust

[188] See the annual reports from the Islamic International Arab Bank.
[189] 2005 Jordan Islamic Bank Annual Report, page 27.

Table 4.3: Percent Makeup of Different Forms of Individual Deposits in Jordan Islamic Bank (1979-2006)

Year	Specific Investment Accounts	Muqarada Bonds	Trust Accounts	Joint Investment Accounts
1979	20	0	51	29
1980	7	0	38	54
1981	3	0	47	50
1982	2	0	45	53
1983	5	0	34	62
1984	7	0	25	68
1985	9	0	21	70
1986	11	0	19	71
1987	9	0	18	73
1988	9	0	18	73
1989	10	0	21	69
1990	7	0	19	74
1991	5	0	19	76
1992	5	0	19	77
1993	5	0	19	76
1994	3	0	19	78
1995	3	0	18	80
1996	3	0	17	80
1997	5	1	16	78
1998	9	2	17	72
1999	13	3	16	69
2000	16	7	17	60
2001	15	9	17	59
2002	11	13	19	56
2003	9	8	22	60
2004	7	8	24	61
2005	5	12	25	58
2006	6	11	25	58

Accounts fell by 11%. The only other year in which Trust Account deposits experienced negative growth was 1996, the year Jordan was in the midst of a recession and a country-wide liquidity crisis. The fall in Trust Account deposits was responsible for the overall drop in deposits that JIB experienced in 1996 and occurred when high interest rates in the country pushed depositors away from accounts that did not provide returns.

There has been very rapid growth in deposits in Trust Accounts in recent years with a rise from JD101.8 million in 1999 (16% of total deposits) to JD375.4 million in 2006 (25% of total deposits). This increase is largely due to the increased services provided to those with Trust Accounts as JIB, forced to compete with the Islamic International Arab Bank, has been improving its technology infrastructure and adding services that did not exist before.

Specific (or Restricted) Investment Accounts are the other kind of deposit that began at a high level in JIB's first year of operations but then declined as an overall percentage of deposits in the bank. Specific Investment Accounts are cash deposits (almost always in foreign currencies) received by the bank to be invested in a specific project or used for a specific purpose. The overwhelming majority of such projects involve commodity trading in international markets with a small percentage used for real estate investments or other kinds of business transactions. Since the deposits are placed for specific purposes, the profits and losses from such deposits are kept separate from the results of other bank investments. In 1979, JD1 million (20% of total deposits in JIB) were in the form of Specific Investment Accounts. This amount however declined the next year to 7% of overall deposits and has remained at about that level with slight fluctuations ever since. The fastest period of growth in Specific Investment Accounts occurred from 1996 to 2000 when Jordan was suffering from a recession and those with hard currencies preferred commodity trading on the international markets over investing inside Jordan. During that time, the amount deposited in Specific Investment Accounts in JIB went from a low of JD13.4 million at the end of 1995 (3% of total deposits in JIB) to JD118 million at the end of 2000 (16% of the total deposits). Since then, the amount deposited has declined and by the end of 2005, only JD66.9 million were invested in Specific Investment Accounts, making up only 5% of total deposits in JIB.

Muqarada Bonds, or investment portfolios, provide a relatively new way to deposit in JIB that began modestly in 1997 and has increased rapidly since. Muqarada Bonds are issued by JIB to cover the costs of specific investment opportunities that the bank defines. After defining a project, the bank issues a portfolio to cover its capital requirements and then invites the public to subscribe to the portfolio through the purchase of bonds. The bonds mature when the project is liquidated and profits are then distributed among the holders of the bonds with the bank taking a pre-determined percentage of the profit. Individuals can also sell their shares back to the bank or to others at any time before full maturation. In 1997, JD7.8 million in Muqarada Bonds were issued constituting about 1% of overall deposits in JIB. By the end of 2006, there was a combined capital of JD167 million deposited in such bonds making them more than 11% of overall individual deposits in the bank.

The final manner in which individuals can deposit money in JIB is through Joint (Unrestricted) Investment Accounts which are somewhat similar to savings accounts in conventional banks. The depositor places money in the bank which the bank then uses to make loans/investments. The major difference is that rather than providing a pre-determined interest rate on the deposit, JIB provides a percentage of the profit that the bank earned on the investments that it conducted. In its first year of operations, such deposits made up 29% of overall individual deposits in the bank, but quickly jumped to 55% in the second year and never again fell under 50%. Growth in Joint Investment Accounts was very rapid during the first years of the bank's existence, slowing down somewhat during the 1989 – 1990 recession and then increasing rapidly again until 1996. These accounts steadily increased as a percentage of the overall individual deposits in JIB reaching a peak in 1995 and 1996 when 80% of individual deposits in the bank were deposited in such accounts. Since 1996, the share of Joint Investment Accounts in the overall percentage of individual deposits has steadily declined. From 1996 until 2000 the amount deposited in Joint Investment Accounts experienced almost no growth at all as growth in Specific Investment Accounts increased rapidly. Since 2000, the amount invested in Joint Investment Accounts has grown at about the same rate as the growth in overall deposits and has remained at about 60% of overall deposits in JIB while Muqarada Bonds and Trust Accounts have increased their overall share at the expense of the Specific Investment Accounts.

Clients can make Joint Investment Account deposits in JIB in one of three ways. They can either make deposits into Savings Accounts, from which money can be withdrawn at any time, or into Notice Accounts, from which money can be withdrawn with three months notice, or into Fixed Term Accounts in which the deposit is placed for a one year term. At the end of the year, the bank determines how much profit it realized from investments made with the money deposited in Joint Investment Accounts. Those with Savings Accounts get 50% of the profit rate on their average annual balance. So, if the bank made 5% profit on the investment basket from Joint Investment Accounts, those with Savings Accounts would realize a profit of 2.5% on their average annual balance. Those with Notice Accounts receive 70% of the profit rate (in our example that would constitute 3.5%) and those with Fixed Accounts get 90% of the profit rate (4.5% in our example).

In the first four years of the bank's history, Savings Accounts constituted about 15% of the overall deposits in Joint Investment Accounts and then declined to about 10% of the overall share (See Table 4.4). They remained constant at about 10% until the year 2000 when they increased to 14% and their overall share has steadily increased since then. This growth can partially be explained by the relatively high profit rate that JIB has been providing to its depositors in recent years as compared to the interest rates on Savings Accounts provided by other Jordanian banks (see Table 4.5). In 2006, Savings Accounts constituted 20% of the deposits in Joint Investment Accounts, the highest percentage in the banks history.

Notice Accounts were not available in JIB's first year. In the next three years they constituted the most popular form of Joint Investment Account, making up about 60% of overall deposits in such accounts from 1980 – 1982. Since then they have steadily declined in importance and since 2003 they have only accounted for about 3% of overall deposits in Joint Investment Accounts. From 1980 to 1982, Fixed Accounts made up about 25% of the deposits in Joint Investment Accounts. Their overall percentage then gradually increased until they constituted 84% from 1996 - 1998. They have slightly declined in importance since then and in 2006 constituted 77% of overall deposits as the

Table 4.4: Percentages Deposited in Different Forms of Joint Investment Accounts

Year	Saving	Fixed	Notice
1979	14	86	0
1980	16	23	60
1981	14	25	61
1982	17	24	59
1983	13	51	36
1984	11	64	25
1985	10	70	20
1986	10	74	16
1987	10	77	13
1988	10	77	13
1989	11	77	11
1990	10	80	10
1991	10	82	8
1992	11	81	8
1993	7	82	8
1994	10	83	7
1995	10	83	7
1996	9	84	7
1997	10	84	6
1998	11	84	5
1999	12	83	4
2000	14	82	4
2001	14	82	4
2002	15	82	3
2003	16	81	3
2004	17	79	3
2005	19	78	3
2006	20	77	3

percentage in Savings Accounts increased. The large percentage of deposits in Fixed Term Accounts enables JIB to make longer term investments without having to worry about providing immediate liquidity.

Table 4.5: JIB Rate of Return as compared to other banks in Jordan (1980 - 2006)

	Jordan Islamic Bank returns on investments				Central Bank of Jordan weighted avg interest rate	
Year	Percentage of Profits due to depositors	Return on Savings Accounts	Return on Notice Accounts	Return on Fixed Term Accounts	Savings Accounts	Fixed Term Accounts
1980	8.20%	4.10%	5.74%	7.38%	5.00%	6.00%
1981	6.80%	3.40%	4.76%	6.12%	5.00%	6.00%
1982	7.20%	3.60%	5.04%	6.48%	5.00%	6.00%
1983	5.40%	2.70%	3.78%	4.86%	6.25%	8.00%
1984	5.70%	2.85%	3.99%	5.13%	6.75%	8.50%
1985	5.48%	2.74%	3.84%	4.93%	6.75%	8.50%
1986	5.10%	2.55%	3.57%	4.59%	5.75%	7.50%
1987	5.05%	2.53%	3.54%	4.55%	5.75%	7.50%
1988	5.35%	2.68%	3.75%	4.82%	N.A.	N.A
1989	7.25%	3.63%	5.08%	6.53%	N.A.	N.A
1990	7.85%	3.93%	5.50%	7.07%	5.18%	8.23%
1991	7.84%	3.92%	5.49%	7.06%	5.00%	7.82%
1992	6.45%	3.23%	4.52%	5.81%	5.01%	6.95%
1993	7.25%	3.63%	5.08%	6.53%	5.14%	6.87%
1994	7.10%	3.55%	4.97%	6.39%	4.96%	7.33%
1995	6.14%	3.07%	4.30%	5.53%	5.01%	7.97%
1996	5.16%	2.58%	3.61%	4.64%	5.22%	8.85%
1997	5.40%	2.70%	3.78%	4.86%	4.79%	8.91%
1998	5.61%	2.81%	3.93%	5.05%	4.56%	8.33%
1999	4.26%	2.13%	2.98%	3.83%	4.19%	7.89%
2000	4.32%	2.16%	3.02%	3.89%	3.76%	6.55%
2001	4.30%	2.15%	3.01%	3.87%	2.91%	5.19%
2002	4.10%	2.05%	2.87%	3.69%	1.84%	3.97%
2003	4.49%	2.25%	3.14%	4.04%	0.88%	2.75%
2004	5.50%	2.75%	3.85%	4.95%	0.73%	2.49%
2005	5.01%	2.51%	3.51%	4.51%	0.83%	3.52%
2006	5.05%	2.53%	3.54%	4.55%	0.99%	5.13%

Source: the JIB figures are from the JIB annual reports and the Central Bank figures are from the Central Bank of Jordan website: http://www.cbj.gov.jo

Table 4.5 shows the returns on investments that the Jordan Islamic Bank has provided its Joint Investment Account depositors from 1980 until 2006 and compares these rates to the interest rates provided by other banks in Jordan (weighted by the volume of deposits) as published by the Central Bank of Jordan. In its first three years of operations, JIB provided its holders of Fixed Accounts a profit rate that was higher than the average interest rate on similar kinds of Fixed Accounts in other Jordanian banks. The returns on Savings Accounts provided by JIB was however considerably lower than the average interest rates provided by conventional banks in the country.

In 1983, the profit rates that JIB provided then fell and became substantially lower than conventional banks interest rates until very recently when JIB's rates again became competitive as the conventional interest rates dropped dramatically. In 2003 and 2004, profits given by JIB to holders of Fixed Term Accounts was again higher than the average in Jordan and since 2002 the profits given to holders of Savings Accounts in JIB have been substantially higher than the rate of interest given to holders of Savings Accounts in other Jordanian banks.

The significant social impact of JIB in Jordanian society is underscored by the fact that it provided an outlet for savings and investment for such a large section of Jordanian society despite the fact that for most of its existence it paid much lower rates of return than conventional banks. Rapid growth in years such as 1983 – 1987 when JIB was paying rates of return that were consistently about half of what conventional banks were paying highlights the willingness of a large section of Jordanian society to sacrifice financial gains to ensure the Islamic propriety of their investments. This is a further indication that many of those who deposited their money in JIB would most likely have kept their money out of the banking system were it not for the existence of an Islamic bank.

Table 4.6: JIB Financing (1979 - 2006)

(Millions of JD)

Year	Total Financing		Al-Murabaha			Al-Mudaraba	Al-Musharaka	Specified Investments	Loans (al-Qirdh al-Hassan)
	Value	% Growth Rate	1. Murabaha Financing	2. Financing Bills	Total (1+2)				
1979	0.59		0.13	0.37	0.50	0.03	0.02		0.04
1980	7.63	1193%	0.50	5.43	5.93	0.10	0.72	0.83	0.05
1981	13.03	71%	1.08	9.30	10.38	0.70	1.02	0.88	0.05
1982	24.68	89%	1.17	19.44	20.61	0.71	1.95	1.23	0.18
1983	37.51	52%	5.82	24.29	30.11	0.99	2.88	3.15	0.38
1984	56.19	50%	20.14	25.50	45.64	0.18	4.48	5.64	0.25
1985	64.78	15%	21.97	27.05	49.02	0.18	5.19	10.10	0.29
1986	85.56	32%	33.94	32.24	66.18	0.16	5.67	13.18	0.37
1987	93.65	9%	33.92	38.15	72.07	0.19	5.73	15.35	0.31
1988	102.58	10%	37.60	43.20	80.80	0.42	5.02	15.89	0.45
1989	125.76	23%	54.93	46.29	101.22	0.92	4.49	18.59	0.54
1990	118.94	-5%	55.26	43.50	98.76	1.22	4.36	13.94	0.66
1991	149.16	25%	90.34	37.39	127.73	1.12	4.65	14.97	0.69
1992	167.13	12%	108.43	35.81	144.24	1.56	4.59	15.98	0.76
1993	199.79	20%	134.07	35.18	169.25	3.60	4.94	21.15	0.85
1994	254.75	28%	187.78	43.56	231.34	1.38	5.99	14.60	1.44
1995	314.18	23%	239.88	51.42	291.30	0.72	7.53	13.15	1.48
1996	357.02	14%	273.22	54.30	327.52	1.52	10.46	15.86	1.66
1997	296.69	-17%	202.68	60.02	262.70	1.19	10.66	20.11	2.03
1998	327.00	10%	199.25	67.33	266.58	0.83	11.05	46.42	2.12
1999	356.96	9%	184.06	74.14	258.20	0.48	11.42	82.86	4.00
2000	377.44	6%	176.54	67.27	243.81	0.00	12.05	117.94	3.64
2001	370.39	-2%	163.31	65.02	228.33	0.06	11.90	126.50	3.60
2002	377.49	2%	180.20	73.55	253.75	0.00	12.03	108.12	3.59
2003	394.00	4%	201.49	80.02	281.51	0.03	12.23	95.25	4.98
2004	424.27	8%	227.75	99.89	327.64	0.00	12.02	79.90	4.71
2005	497.01	26%	294.97	116.65	411.62	0.00	12.44	66.86	6.09
2006	650.08	53%	386.35	157.80	544.15	0.00	12.94	87.25	5.74

While the existence of Islamic banking seems likely to have had an impact on Jordan's CIM ratio and that in and of itself represents an important development. A bank's impact on society is even more pronounced in how it uses the money it has than in the mere fact that it collects deposits. JIB uses its money both to finance the monetary needs of others and to make direct investments. JIB finances others through the use of *murabaha*, *musharaka*, and *mudaraba* contracts as well as through the financing of specified projects and activities. It also provides no-interest loans (al-Qirdh al-Hassan) for some specified purposes. Table 4.6 outlines the amount and growth of money that JIB has used to finance activities in Jordan from the bank's inception in 1979 through 2006.

Just as JIB's assets and the level of deposits in the bank have shown rapid growth, the amount of money that JIB has in turn provided to finance others has grown. Annual growth rates in financing were high every single year from the bank's inception in 1979 until 1996, with the only exception being in 1990 during the Gulf War. Since 1996, growth rates have slowed dramatically. In 1997, there was a large drop in the amount of money JIB used to finance activities in Jordan and the annual growth rates were modest from that year until 2004. In 2005 and 2006, the growth rates again shot up dramatically from a total of JD424 million in 2004 to JD650 million in 2006.

From the standpoint of those who advocate JIB using its financial clout to achieve important social and national objectives through the use of *musharaka* and *mudaraba* contracts, one very disappointing aspect of its financing activities has been the overwhelming percentage of financing that goes into *murabaha* transactions. Table 4.7 shows that the percentage of financing that is based on *murabaha* contracts never fell below 60% and that it was over 75% every year from 1979 until 1998 and then again from 2004 until 2006.

Table 4.7: Forms of JIB Financing in Percentages

Year	Murabaha	Mudaraba	Musharaka	Specified Investments	al-Qirdh al-Hassan
1979	85%	5%	3%	0%	7%
1980	78%	1%	9%	11%	1%
1981	80%	5%	8%	7%	0%
1982	84%	3%	8%	5%	1%
1983	80%	3%	8%	8%	1%
1984	81%	0%	8%	10%	0%
1985	76%	0%	8%	16%	0%
1986	77%	0%	7%	15%	0%
1987	77%	0%	6%	16%	0%
1988	79%	0%	5%	15%	0%
1989	80%	1%	4%	15%	0%
1990	83%	1%	4%	12%	1%
1991	86%	1%	3%	10%	0%
1992	86%	1%	3%	10%	0%
1993	85%	2%	2%	11%	0%
1994	91%	1%	2%	6%	1%
1995	93%	0%	2%	4%	0%
1996	92%	0%	3%	4%	0%
1997	89%	0%	4%	7%	1%
1998	82%	0%	3%	14%	1%
1999	72%	0%	3%	23%	1%
2000	65%	0%	3%	31%	1%
2001	62%	0%	3%	34%	1%
2002	67%	0%	3%	29%	1%
2003	71%	0%	3%	24%	1%
2004	77%	0%	3%	19%	1%
2005	83%	0%	3%	13%	1%
2006	84%	0%	2%	13%	1%

The fastest growth in *murabaha* transactions took place from 1990 until 1996 when the overall level of financing through *murabaha* increased from JD98.76 million in

1990 to JD327.52 million in 1996. This growth was largely due to two deals that were contracted with the Jordanian government. The first actually started in 1985 when JIB began purchasing crude oil and selling it to the Jordanian Petroleum Refinery Company which paid for it over a two year period on a *murabaha* basis. The deal was backed up by strong governmental guarantees and was considered a major breakthrough for JIB. In 1991, the Ministry of Planning made a deal with JIB that included many of the same kind of guarantees that the earlier oil deal included. Throughout the early 1990s the amount of goods that JIB purchased and sold to the Ministry of Planning increased until it reached over JD100 million in 1996, representing 22% of the banks overall financing and investing for that year.[190]

The financing granted to the Government or under its guarantee then began a precipitous decline. It dropped from a total of JD113 million in 1996 to JD56 million in 1997, JD40 million in 1998, JD30 million in 1999, JD20 million in 2000, JD9 million in 2001, JD4 million in 2002, JD6 million in 2003, and JD2 million in 2004. In 2005, JIB was not involved in any financing granted to the Jordanian Government. The decline in al-Murabaha deals with the government after 1996 largely explains the fall in overall al-Murabaha transactions after that year. The high of JD327 million in al-Murabaha transactions in 1996 was not again matched until 2004. Since 2004, the amount that JIB has financed through al-Murabaha has again increased significantly from JD327 million

[190] For a good discussion of these deals see Abdullah Abd al-Majeed al-Maliki, *The Jordan Islamic Bank: Vol. 7 Encyclopedia on the History of Banking in Jordan*, (Jordan Printing and Publishing, Amman, 1996) pgs. 167-170.

in 2004 to JD544 million in 2006 with most of the increase in the areas of general trade and transportation services.

Mudaraba and *musharaka* contracts together never constituted even 15% of JIB's overall financing deals and since 1988 they have together never made up more than 5% of its financing agreements. Despite the fact that much of the theoretical work on the potential social benefits of Islamic banking deal with the inherent justice of *mudaraba* and *musharaka* contracts as opposed to more conventional loans, JIB has found it very challenging to actually make such agreements because of the difficulties in identifying projects that would fit into these kinds of Islamic financing schemes and then accurately administering them and reporting and sharing profits.

Another form of financing that JIB provides is based on funds deposited in the bank for specific projects or purposes. Most of these funds are deposited in the bank as foreign currencies and are used to finance commodity trading in international markets with the bank getting a pre-arranged percentage of the profit from such transactions. This form of financing is by far the second largest form after *murabaha* and constituted more than 30% of total financing in 2000 and 2001. By 2006 the amount of money to finance such purposes had declined from JD126 million to JD87 million or from 31% of total financing from JIB to 13%.

The final form of financing that JIB provides is through interest-free loans. From 1979 to 1983 all such interest-free loans were bills of exchange granted to some of its customers for trading purposes. In 1983, the bank began providing interest-free loans (al-Qirdh al-Hassan) to needy citizens as a means of contributing to the overall welfare of society. Most of these loans are granted to help pay for the University expenses of students, the expenses related to marriage, or for medical needs. In 1985, JIB established an al-Qirdh al-Hassan Fund to which depositors could place funds for the use of such social purposes. The bank uses this Fund as well as some of its own resources to finance the interest-free social loans. As Table 4.7 shows, these loans have consistently constituted about 1% of total financing recorded on JIB's annual balance sheets. While this amount is relatively insignificant from the perspective of the bank's overall financing and investment schemes, the funds granted through such loans have had a profoundly positive impact on tens of thousands of Jordanian citizens who could not have acquired the funds needed to pay for their education, get married or pay needed medical expenses without the bank's intervention.

The amounts shown in Tables 4.6 and 4.7 are taken from end-of-the-year balance sheet totals. Such totals do not fully account for the amount of financing that JIB undertakes since part of what is financed is paid back before the end of the year. In the case of the interest-free loans it is worthwhile to look at the total amount of interest-free social loans granted annually to gauge the social impact the bank has had on Jordanian society. Table 4.8 shows the amount of interest-free social loans granted by the bank annually from 1985 to 2006 as well as the number of needy citizens who benefited from the loans. It also shows the total amount of money granted for such purposes and the total number of benefactors from 1985 to 2006.

Table 4.8: Amount of Interest-Free Social Loans granted by JIB with value in thousands of JDs

Year	Value of Loans	Number of Recipients	Year	Value of Loans	Number of Recipients
1985	238	595	1996	2700	7935
1986	381	1107	1997	3200	8435
1987	523	1421	1998	3500	9776
1988	516	1430	1999	3800	10953
1989	859	1625	2000	4000	12078
1990	1100	2664	2001	4200	11212
1991	1130	3131	2002	4400	15319
1992	1280	3962	2003	5400	13618
1993	1500	4235	2004	5600	14613
1994	2200	5792	2005	6700	14369
1995	2100	6318	2006	7300	15506
			Total	**62,627**	**166,094**

Table 4.8 shows that over 166,000 individuals benefited from more than JD62 million (about $100 million) in interest-free loans granted by JIB from 1985 to 2006. In 2006 alone, over JD7 million was provided in interest-free loans to more than 15,000 persons. The JIB interest-free social loan program is well-known in poorer areas of the country and has helped JIB gain credibility as an institution that is concerned about improving overall Jordanian society.

Besides financing others, JIB has used a substantial amount of its available funds to undertake direct investments. JIB first published a classification of its direct investments in its 1994 annual report in which five categories were detailed: participation in investment funds, investments in commodities, investments in securities, real estate investments, and miscellaneous investments. In 1997, the JIB annual reports also began listing investments in portfolios. In 2000, they began breaking down investments in securities into investments in traded securities, investments in affiliated companies and investments in subsidiary companies, and they also began publishing the new category of investments in leasing. Investments in *sukuk* began being published in 2002. Table 4.9 provides the total direct investments JIB has made in these various categories as well as the percentage of each category in overall direct investments for every year from 1994 to 2005.

Table 4.9: Categorization of JIB Direct Investments (millions of JD)

Kind of Investment	1994		1995		1996		1997		1998		1999	
	Total	%	Total	%	Total	%	Total	%	Total	%	Total	%
Investment Funds	31.4	27	25.9	22	16.1	16	23.1	14	27.4	19	24.9	19
Commodities	9.9	8	15.0	13	1.6	2	49.4	30	21.8	15	11.9	9
Securities	52.2	44	53.5	45	54.0	52	56.9	35	62.7	44	62.4	48
Real Estate	22.5	19	22.6	19	24.8	24	23.9	15	25.8	18	25.5	20
Portfolios		0		0		0	2.4	1	1.9	1	3.0	2
Miscellaneous	1.4	1	1.6	1	6.5	6	6.7	4	1.7	1	1.4	1
Total	**117**		**119**		**103**		**162**		**141**		**129**	

Kind of Investment	2000		2001		2002		2003		2004		2005	
	Total	%	Total	%	Total	%	Total	%	Total	%	Total	%
Investment Funds	18.9	14	21.2	12	13.1	6	13.8	8	13.1	6	11.0	5
Commodities	16.4	12	35.6	20	43.0	20	45.3	25	60.6	30	78.2	32
Securities (total)	63.2	47	60.9	35	60.9	28	50.7	28	65.1	32	70.9	29
a. Traded	36.9	27	34.6	20	34.6	16	18.3	10	37	18	42.6	18
b. Aff. Comp.	15.0	11	15.0	9	15.0	7	21.1	12	16.8	8	21.6	9
c. Sub. Comp.	11.3	8	11.3	6	11.3	5	11.3	6	11.3	6	6.7	3
Real Estate	25.6	19	25.2	14	24.8	11	22.5	13	22.5	11	27.4	11
Portfolios	3.1	2	27.8	16	64.3	30	33.6	19	32.7	16	40.0	17
Leasing	3.3	2	3.1	2	3.2	1	3	2	2.8	1	10.2	4
Sukuk					6.0	3	8.4	5	5.9	3	3.3	1
Miscellaneous	5.0	4	1.3	1	2.5	1	1.2	1		0		0
Total	**136**		**175**		**218**		**179**		**203**		**241**	

Securities (or shares in companies) have constituted the main avenue of JIB direct investments throughout the years, constituting 44% of total investments in 1994. They fell to 35% of total investments in 2001 and have remained under 40% ever since, though the largest percentage of investments remained in securities every year except 2002 and 2005. JIB invests in both domestic and foreign securities. JIB's *shari'a* board approves all security investments to ensure that the companies invested in comply with Islamic laws. A large percentage of its overall foreign security investments are in other Islamic banks outside of Jordan.

Part of JIB's security investments also involves ownership or substantial interests in a number of companies inside Jordan. The largest subsidiary company owned by JIB is Al-Omariyya Schools, a chain of private K-12 Islamic schools with a reputation of providing a strong academic program combined with Islamic religious principles and character development. JIB also owns FACT (Future Applied Computer Technology Co.), a company formed in 1998 to provide technology consultations and services to Islamic banks, insurance companies and other financial institutions throughout the Middle East. JIB also owns Al-Samaha Real Estate Company and Al-Rizq Trading Company. JIB serves as an affiliate owning from 25 to 40% of a number of other commercial, real estate, manufacturing, and service companies including Jordan's largest Islamic Insurance Company.

JIB's investments in foreign-based investment funds have steadily declined over the years as an overall percentage of its investments. In 1994 JIB invested more than

JD31 million, constituting 27% of its overall investments, in such funds; whereas, in 2005 JIB only invested JD11 million constituting less than 5% of its overall investments in these funds. A reverse trend has occurred with respect to investments in portfolios. JIB started out modestly in 1997 by investing less than JD3 million in portfolios. This increased dramatically starting in 2001 with a jump from 2% of its overall investments to 16% in 2001 and then 30% in 2002 with over JD64 million invested in portfolios. By 2005, investments in portfolios declined slightly to JD40 million, constituting 17% of JIB's total investments. Other major areas of investment for JIB include commercial real estate and residential housing complexes that have fluctuated between 11% and 24% of JIB's overall investments and investments in internationally traded commodity exchanges which have fluctuated widely between 2% and 32% of JIB's overall investments.

Table 4.10 shows the growth in JIB investments over the years as well as the percentage of funds that JIB has used for direct investments as compared to financing. The Table shows that growth in the amount of funds invested by JIB has grown rapidly over the years. A big jump occurred between 1983 and 1984 when invested funds increased from less than JD3 million to nearly JD13 million. Invested funds continued increasing rapidly until 1993 when JIB had JD129 million in investments constituting 39% of total financing and investments. Since then, the amount of money invested by JIB has fluctuated up and down based on market conditions and investments declined as an overall percentage of financing and investment, though they have remained between 22% and 39% since 1986. In 2005, JIB had JD241 million in investments constituting 33% of overall financing and investments. It is rare for a conventional bank to

Table 4.10: JIB Direct Investments as % of Total Financing and Investment 1979-2005 (millions of JDs)

Year	Total Finance & Invest	Financing	Investment	Percent growth in Invest.	Invest. as a % of total
1979	0.8	0.6	0.2		23
1980	7.6	7.6	0.0		0
1981	16.0	13.0	2.9		18
1982	27.9	24.7	3.2	9	11
1983	40.1	37.5	2.6	-18	7
1984	68.9	56.2	12.7	387	18
1985	81.4	64.8	16.6	31	20
1986	109.0	85.6	23.4	41	22
1987	124.7	93.7	31.0	32	25
1988	140	103	38	22	27
1989	163	126	37	-1	23
1990	163	119	45	19	27
1991	209	149	60	34	29
1992	260	167	93	56	36
1993	329	200	129	39	39
1994	372	255	117	-9	31
1995	433	314	119	2	27
1996	460	357	103	-13	22
1997	459	297	162	57	35
1998	468	327	141	-13	30
1999	486	357	129	-9	27
2000	513	377	136	5	26
2001	545	370	175	29	32
2002	595	377	218	25	37
2003	573	394	179	-18	31
2004	627	424	203	13	32
2005	738	497	241	19	33

consistently employ between a fifth and a third of its funds in direct investments but Islamic banks perceive direct investments as an important aspect of its overall financial role. JIB's impact on Jordanian society has been enhanced significantly over the years by the fact that it has been a major direct investor in the economy.

The manner by which JIB's financial and investment employments have had a social impact on society can better be seen through an analysis of where such funds have actually been spent. JIB has over the years either financed or directly invested in various economic and social sectors including hospitals, clinics, universities, schools, educational institutions, transport services and industrial and commercial projects. Table 4.11 breaks down the sectoral distribution of total financing and investment by the JIB from 1979 to 2005. The Table shows that in the bank's initial years it's financing and investing was heavily skewed toward General Trade and Commercial activities. The financing of such areas fell dramatically in the late 1990s but then picked up again starting in 2003 and constituted more than one-fourth of overall financing and investing in 2006.

Financing and investment in industry and mining has fluctuated over the years with relatively high levels between 1983 and 1992. Much of the financing during those years dealt with the deals backed up by the government in which JIB financed the purchase of large amounts of crude oil. After those deals phased out in the early 1990s, the overall employment of funds in mining and industry declined, ranging from 4.9% to 11.4% of overall financing and investment between 1993 and 2006.

The financing of construction projects and directly investing in real estate companies has also constituted an important part of JIB's role in society, especially since the mid-1990s. The construction sector has taken 20% of overall funds every year since

1994 and has constituted the largest single sector since 1997. In 2006, more than a third of JIB's overall financing and investment went to this sector.

Table 4.11: Sectoral Distribution of JIB Financing and Investment

Year	Industry & Mining	General Trade	Construction	Transport	Agriculture	Other
1979	5.7%	65.0%	1.3%	26.0%	0.0%	2.0%
1980	10.6%	63.5%	11.3%	10.9%	0.0%	3.7%
1981	6.4%	43.1%	22.1%	16.6%	1.1%	10.7%
1982	5.5%	35.7%	22.5%	22.4%	0.7%	13.2%
1983	15.8%	35.8%	18.0%	14.5%	1.0%	14.9%
1984	26.6%	21.9%	17.3%	13.7%	0.4%	20.1%
1985	28.6%	23.8%	18.2%	9.4%	0.6%	19.4%
1986	34.9%	22.9%	17.2%	9.9%	0.5%	14.6%
1987	32.8%	23.5%	16.2%	5.3%	0.5%	21.7%
1988	25.9%	27.9%	13.4%	4.7%	0.7%	27.4%
1989	32.0%	22.2%	15.1%	3.5%	0.7%	26.5%
1990	22.1%	24.0%	15.1%	3.9%	0.7%	34.2%
1991	21.6%	26.0%	10.9%	2.5%	0.5%	38.5%
1992	14.6%	26.7%	13.3%	1.4%	0.4%	43.6%
1993	9.2%	28.3%	10.1%	2.2%	0.2%	50.0%
1994	7.4%	29.3%	29.8%	6.3%	0.3%	26.9%
1995	7.3%	31.2%	24.5%	5.6%	0.3%	31.1%
1996	11.4%	25.5%	20.7%	6.0%	0.3%	36.1%
1997	10.8%	11.2%	21.6%	6.4%	0.3%	49.7%
1998	10.5%	11.3%	22.5%	6.0%	0.4%	49.3%
1999	7.7%	13.2%	23.6%	7.4%	0.3%	47.8%
2000	5.5%	12.6%	24.6%	8.7%	0.3%	48.3%
2001	4.9%	12.5%	23.7%	9.3%	0.3%	49.3%
2002	6.6%	11.5%	23.7%	9.5%	0.2%	48.5%
2003	7.1%	20.1%	24.7%	12.1%	0.3%	35.7%
2004	9.4%	22.8%	29.3%	15.7%	0.4%	22.4%
2005	8.8%	22.2%	33.2%	18.6%	0.8%	16.4%
2006	7.0%	26.0%	34.0%	19.0%	0.4%	13.6%

The JIB has also played an important role in the transport sector. When the JIB opened in 1979 it provided the first opportunity for many devout Muslims to finance the purchase of vehicles and the bank used a large percentage of its funds in this sector. The transport sector then declined precipitously and in 1992 less than 2% of its funds were used in the transport sector. The sector has risen significantly since then and by 2006 almost a fifth of its overall funds were employed in the transport sector.

JIB has never been actively involved in the agricultural sector and in only two years did it employ more than 1% of its funds toward agriculture. This has actually been an area that political Islamists strongly advocate and the political Islamists have been especially critical of JIB for not doing more to help this sector.

JIB's bank statements note that in a number of years the largest single sector was "Other," constituting half of JIB's overall financing and investment in 1993 and more than 40% in a number of years. This category largely constitutes the financing of and investment in professional and business activities that don't fall under the government definition of general trade.[191]

While Table 4.2 on total deposits and Table 4.6 on total financing showed the total amount of funds either deposited in JIB or loaned out from JIB, perhaps the overall social role of the bank is better underscored by looking at the number of people the bank has served. In its 30th Annual Report, the JIB provided detailed numbers for both the number of deals it financed as well as the number of deposits that were held in the bank from 1999 to 2008. In previous years, these figures were recorded in a different manner that makes it difficult to show growth over time (they had previously included dormant accounts and the figures were given in general rather than specific form).

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[191] Abdullah Abd al-Majeed al-Maliki, *The Jordan Islamic Bank: Vol. 7 Encyclopedia on the History of Banking in Jordan*, (Jordan Printing and Publishing, Amman, 1996) page 216.

Table 4.12: Number of People Dealing with JIB

	(thousands)		
Year	Deals financed by JIB	No. of accounts in JIB	Jordan Population (in millions)
1999	54.5	365.1	4,681
2000	54.4	497.9	4,798
2001	52.5	524.6	4,918
2002	55.3	548.5	5,038
2003	62.6	545.3	5,164
2004	67.3	543.0	5,290
2005	77.6	578.5	5,412
2006	84.0	597.6	5,538
2007	96.6	632.9	5,719
2008	108.3	702.3	5,906

Source: JIB 30th annual report, Population Figures from World Bank Development Indicators.

Table 4.12 shows that in 2008, JIB was financing more than 108 thousand deals and there were more than 702 thousand active accounts in the bank. Considering that the population of the country was less than 6 million people and about 37% of the population was under 15 years old,[192] this means that there was approximately 1 active account for every 4 Jordanians over 15 years old and there was one loan or financing deal for every 28 Jordanians over 15 years old. The large number of deposits and financing deals relative to the country's population perhaps more than any other figure underlie the extent to which JIB has infiltrated the Jordanian market. The large numbers also are an indication that many customers of JIB are dealing with small amounts of money and that the bank is willing and able to serve those dealing in such amounts.

[192] Population Reference Bureau, 2009 World Population Data Sheet, available at: http://www.prb.org/Publications/Datasheets/2009/2009wpds.aspx.

The JIB has played an important social role in bringing banking services to the poorest residential areas of the country, areas that are underserved by conventional banks. While JIB has not been able to play a leading role in attracting large businesses as customers and has faced challenges in competing with conventional banks in offering the kinds of financing services required by large commercial and industrial interests, it has been a leading bank in Jordan in providing banking services to Jordanians of low socio-economic status. The majority of Jordan's population lives in areas that would be considered of low socio-economic status and JIB has played a trailblazing role in bringing into the banking sector thousands of Jordanian families that had previously not been involved in banking.

Table 4.13: Distribution of Bank Branches in Jordan

	Residential Areas SES			Industrial/ Commercial		Low SES	Low SES
	High	Mid.	Low	Zones	**Total**	as % of total	as % of residential
Housing Bank	2	24	36	33	**95**	38	58
Arab Bank	4	20	13	40	**77**	17	35
Bank of Jordan	2	10	16	34	**62**	26	57
Jordan Islamic Bank	3	11	21	21	**56**	38	60
Cairo-Amman	0	11	7	35	**53**	13	39
Bank Ahli	1	4	7	36	**48**	15	58
Jordan-Kuwait	5	13	4	22	**44**	9	18
Int. Islamic Arab Bank	1	2	2	12	**17**	12	40
Total	**18**	**95**	**106**	**233**	**452**	**23**	**48**

The data for this table was obtained from an analysis of bank branches undertaken with help from the Middle East Studies Center located in Amman, Jordan for the purposes of this dissertation.

Table 4.13 captures the significance of JIB's role in serving the residential banking needs of Jordan's poorest sectors by comparing the locations of the branches of all Jordanian banks which have at least 40 branches (with the International Islamic Arab

Bank included for comparison purposes). Of all Jordanian banks, only the Housing Bank has more branches in areas of low socio-economic status than JIB. The Housing Bank was established in Jordan in 1974 as a quasi-governmental bank aimed at serving the residential banking needs of Jordanian citizens.[193] The Jordanian Minister of Economy at the time, Mohammed Saeed Nabulsi, came up with the idea for the bank and it was largely established by the Jordanian Central Bank.[194] JIB has more branches in areas of low socio-economic status than every other bank in the country including the Arab Bank which is about 20 times larger than JIB in terms of overall assets.

Of JIB's total of 56 branches, 21 are in areas of low socio-economic status making 38% of its banks in such areas. This is the same percentage as that of the Housing Bank and a much larger percentage than any other bank in the country. When not including bank branches located in commercial or industrial zones, 60% of JIB's residential banks are located in areas of low socio-economic status as compared to 58% of the Housing Bank's residential branches. The comparison of bank branch location shows that JIB depends on low income residential customers for a greater percentage of its business than any other bank in Jordan and that JIB is playing a crucial role in serving the needs of Jordan's neediest citizens.

A growing body of literature highlights the importance of inclusive financial systems and how financial systems that are able to serve lower socio-economic classes

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[193] Abdullah Abd al-Majeed al-Maliki, *The Housing Bank, The Industrial Development Bank: Vol. 3 Encyclopedia on the History of Banking in Jordan*, (Jordan Printing and Publishing, Amman, 1995) page 13.
[194] Ibid.

profoundly impacts income distribution and a country's growth rate.[195] Even in countries with well-developed financial systems to which the poor have access, Islamic cultural sensitivities often prevent a large proportion of the population from using such facilities. In Jordan, governmental support for the Housing Bank indicates an awareness of the importance of providing finance to all segments of the population. However the rapid growth of the Jordan Islamic Bank and its prominence in poorer areas of the country indicates strong popular resistance to conventional interest-based finance. The JIB filled an important need by providing a culturally authentic means for many Jordanians – especially from lower socio-economic classes - to gain a foothold in the Jordanian economy. By providing a culturally authentic means of finance and investment, the JIB helps reduce the damaging concentration of economic power in Jordan and empowers a segment of the population that had earlier been marginalized.

Much of the commercial and business sector within Jordan is predominantly Palestinian in origin and the large Arab Bank has often been described as a bank that predominantly serves the Palestinian population.[196] While both Jordanians and Palestinians have freedom to live throughout the country, there are certain areas that are predominantly inhabited by people of Palestinian origin and others by people of Jordanian origin. While this is a very sensitive issue in the country and determining these areas is not exact, the location of bank branches can underscore the extent to which the

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[195] Patrick Honohan, *Financial Sector Policy and the Poor: Selected Findings and Issues*, (World Bank, Washington D.C. 2004). Also see Raghuram Rajan and Luigi Zingales, *Saving Capitalism from the Capitalists*, (Princeton University Press, Princeton N.J. 2004).

[196] Rodney Wilson, "The Growth of Islamic Banking and Product Development Among Islamic Retail Banks," in Sohail Jaffer (ed.), *Islamic Retail Banking and Finance: Global Challenges and Opportunities*, (London: Euromoney Books, 2005), 18

large banks in Jordan serve both communities. Table 4:14 shows that the Jordan Islamic Bank is one of the few banks in Jordan that evenly distributes its branches among both Palestinian and Jordanian communities. Only the Housing Bank, the Bank of Jordan, and the Jordan Islamic Bank have a nearly equivalent number of branches in predominantly Jordanian areas as they do in the more banked Palestinian areas. This is another indicator that JIB serves an important social function of providing banking services to a portion of the population that had previously not had adequate access to credit facilities.

Table 4.14: Palestinian:Jordanian Distribution of Bank Branches in Jordan

	Pal.	Jord.	Mixed.	**Total**	Pal:Jor	Jordanian branches as % of Total
Housing Bank	34	34	27	**95**	1.00	36
Arab Bank	30	18	29	**77**	1.67	23
Bank of Jordan	22	20	20	**62**	1.10	32
Jordan Islamic Bank	19	17	20	**56**	1.12	30
Cairo-Amman	26	14	13	**53**	1.86	26
Bank Ahli	21	15	12	**48**	1.40	31
Jordan-Kuwait	17	9	18	**44**	1.89	20
Int. Islamic Arab Bank	8	3	6	**17**	2.67	18
Total	**177**	**130**	**145**	**452**	1.36	29

The data for this table was obtained by the author through discussions with a number of people living in Jordan.

CONCLUSION

While the JIB has not lived up to the utopian expectations of many of the theoretical writers of Islamic banking and Islamic economics in general, it has played an important social role in Jordan. Its rapid and continuing growth rate – despite providing a smaller return for most of its history than were provided by conventional banks – is a clear indication of the bank filling a needed void and thus playing an important role in bringing banking services to a segment of the population that had not been comfortable with the interest-bearing conventional banking system. This is further underscored by the large number of depositors and lenders that use the bank and the fact that it has made a deliberate attempt to reach out to those of lower socio-economic levels that were ignored by most of the other banks in Jordan. Tens of thousands of people have benefited from JIB's no-interest social loan program and the bank has spent millions on different charitable causes over the years. It is also an important investor in Jordan in its own right investing in schools, hospitals and numerous other projects.

On the downside, the JIB has not been able to break away from its dependence on Murabaha financing, which in fundamental economic terms is almost no different than interest-bearing loans. The benefits that profit-sharing finance could theoretically provide to an economy and the social justice component that is often claimed accompany Islamic banking schemes have not been adequately tested by JIB since almost none of its actual financing follows true profit-sharing formulas. Much to the chagrin of many of the theoretical advocates of Islamic banking, JIB – like other Islamic banks worldwide – is fundamentally a profit-seeking business concerned much more with maximum efficiency and the economic interests of its shareholders than with social justice.

At times, the JIB was spending almost a third of its funds on international commodity exchanges – a type of financing that brought absolutely no social or economic benefit to Jordan and there is no evidence that JIB ever deliberately sought out major financing schemes that were aimed at bringing about social justice in the country. Critics note that by cooperating closely and coordinating their actions with conventional and global financial systems, Islamic banks have served the role of bringing Muslims into a global financial order that violates Islamic principles and that they have thus delayed the kind of transformational social and economic changes that Islam calls for rather than spur their development. This is precisely the critique that Tariq Ramadan, perhaps the world's most well-known Islamic philosopher and intellectual, has leveled against Islamic banking.[197] Certainly, after closely analyzing JIB, an argument could easily be made that the JIB is guilty of the accusations those like Ramadan are making. Muslims who had previously boycotted conventional banks and finance have been accommodated through the JIB in a way that hinders them from devising other kinds of financial devices that would be more true to the deeper principles of Islamic economics.

This underscores the importance of looking closely at how political Islamists in Jordan have viewed the JIB. While supportive of the idea of Islamic banking and finance, Islamists in Jordan have become increasingly critical of the JIB in recent years. The relationship between financial Islamists and political Islamists in Jordan could potentially have transformative political effects in the country even if the transformative social and economic changes promised by Islamic banking have not been realized.

Chapter Five will look closely at the relationship between political and financial Islamists in Jordan and as well as the relationship of both to the government. The

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[197] Tariq Ramadan, *Islam, the West and the Challenges of Modernity*, (Leicester: The Islamic Foundation, 2004), 171-174. Also See the online dialogue between Tarek El Diwany and Muhammad Nejatullah Siddiqi, "A Discussion with Professor Siddiqi," *Islamic Finance.com*. Available from http://www.islamic-finance.com/item141_f.htm. Accessed on December 10, 2010; Internet.

interplay of these relations is important not only for the growth and development of the Islamists – both financial and political – but could also have ramifications on larger political issues, such as the state's relations with the Islamist political movement and even the further development of democratic institutions in the country.

CHAPTER FIVE: ISLAMIC BANKING & ISLAMIST POLITICS IN JORDAN

The main contention of political Islamists is that Islam is a complete way of life that encompasses rules and regulations, not only for spiritual and moral uplift, but also for how to establish and maintain political, economic, social and other systems. This was the first of twenty basic principles that Hassan al-Banna, the founder of the Muslim Brotherhood, stated in a treatise[198] he wrote to explain the understanding of Islam held by his movement, which was the first Islamist organization of the modern era and the largest and most well-known of those groups until today. Al-Banna believed that the main role of his movement, and of Islamists in general, was to re-establish those aspects of the comprehensive Islamic religion that had been lost or destroyed before, during, or after the colonial era. The establishment of Islamic Banks in the second half of the twentieth century could be seen as a practical application of the ideological view that Islam contained within it an alternative means of running economic and financial affairs.

The ties between Islamic banks and Islamic movements have not, however, been as strong as might be expected. In this chapter, the role Islamists played in the early history of the Jordan Islamic Bank (JIB) is examined, as well as the ongoing relationship and kinds of interaction between Islamists and both the JIB and the Islamic International Arab Bank. The economic agenda of the Islamic Action Front Party is also discussed, as is that of Islamist activists in professional organizations and other aspects of civil society.

[198] Hasan al-Banna, "Risalat al-Ta'aleem," from *Majmu'at Rasail al-Imam al-Shaheed Hasan al-Banna*, (Dar al-Da'wa, Alexandria, Egypt). Al-Banna is the grandfather of Tariq Ramadan, the intellectual quoted at the end of chapter 4, who, like his grandfather, continues to advocate the notion that Islam is a complete way of life.

The Role of Islamists in the Establishment of the Jordan Islamic Bank

The 1970s was a decade of extensive institutionalization for Islamists in Jordan.[199] In the aftermath of the 1967 war, the popularity of Islamic movements and Islamism as an ideology increased dramatically throughout the Arab world, including in Jordan. By siding with the monarchy in Jordan's 1970 civil war, the Muslim Brotherhood in Jordan also began enjoying an almost semi-official status in the 1970s, a status that enabled it to establish numerous new charitable, educational, and healthcare institutions in the Kingdom.

It was in this milieu of both increased popularity and increased institutionalization that many Jordanian Islamist leaders and intellectuals began discussing the concept of "Islamic economics" and thinking about the possibility of establishing Islamic financial institutions in Jordan and elsewhere. The books and articles of the Pakistani Islamist intellectual Abu'l-A'la Mawdudi, who had been writing about Islamic economics since the 1940s, were widely discussed among Islamists in Jordan in the 1970s. The success of

[199] See Ali Abdul Kazem, "Al-Seera al-Tareekheya Li-Jama'at al-Ikhwan al-Muslimeen wa-Murji'iyyatiha al-Fikriya," from Hani Hourani ed., *al-Harakaat wa-Tanzhimaat al-Islamiyya fil-Urdun*, (al-Urdun al-Jadid Research Center, Amman, Jordan, 1997).

the Mit Ghamr savings/investment houses in the Egyptian countryside were also looked to by Islamists as proof of the feasibility of Islamic banking.[200]

The Mit Ghamr houses were established in Egypt in 1963 by Ahmed Al-Najjar. While al-Najjar was not himself an Islamist the institutions he established worked on the principle of interest-free financing and many members of the Egyptian Muslim Brotherhood worked and invested in them. The Mit Ghamr experiment came to a quick end in 1968 when the banks were liquidated by the Egyptian government.[201] The short-term experiment was influential, however, as Islamists perceived it as having provided a practical example of Islamic banking in the modern era. The banks fueled the aspirations of Islamists in Jordan and elsewhere to establish a more enduring Islamic alternative to the prevailing economic and financial institutions.[202]

The establishment of two Islamic banks in 1975 also encouraged Jordanian Islamists. In that year, the Organization of the Islamic Conference established the Islamic Development Bank in Jeddah to finance government projects in the Muslim

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200 For the social and economic workings of the Mit Ghamr banks see: Ahmed El-Ashker, *The Islamic Business Enterprise* (Croom Helm, London 1987) and Ann Elizabeth Mayer, "Islamic Banking and Credit Policies in the Sadat Era: The Social Origins of Islamic Banking in Egypt," Arab Law Quarterly, 1.1 pp. 32-50 as reprinted in Tim Niblock and Rodney Wilson ed., *The Political Economy of the Middle East* (Cheltenham: Edward Elgar, 1999), Vol. 3, pp. 389-407.

201 The reason for the liquidation of the Mit Ghamr banks is a source of controversy. The Egyptian government claimed that the banks were being mismanaged, however both Mayer (Arab Law Quaraterly, p. 395-396) and El-Ashker (The Islamic Business Enterprise, p. 158-161) argue that political reasons were behind the demise of the bank. Islamists in Egypt, Jordan and elsewhere continue to argue that the Egyptian government closed the banks because of the fear that they would strengthen Islamist sentiments.

202 Jamil Abu Bakr, the spokesman for the Jordanian Muslim Brotherhood, noted in an interview on July 23, 2001 that members of the Muslim Brotherhood were the first to discuss the idea of establishing an Islamic bank in Jordan in the early 1970s.

countries and the Dubai Islamic Bank was established in the United Arab Emirates.[203] These two banks were dedicated to working on Islamic principles, but it was still unclear at the time exactly what that entailed.

The person who perhaps did more than any other to provide substance to the concept of Islamic banking in the 1970s was Sami Hamoud, a Jordanian economist who had been working at the Jordanian National Bank since 1956. Hamoud was not himself a member of any Islamist organization nor did he have any outwardly Islamist tendencies.[204] His father, however, was an Islamic scholar who had always encouraged his son to use his knowledge of economics and finance to devise methods of interest-free banking. After working at the National Bank for a number of years and witnessing many of the shortcomings of an interest-based financial system, Hamoud became convinced that an interest-free system was not only feasible but also ultimately more just and superior to conventional banking methods. Believing that all the earlier writings about Islamic banking were superficial, Hamoud became determined to write his PhD dissertation on the concept of interest-free banking and how it would work in the modern world. Published in 1976, the dissertation was widely viewed as the most substantial academic piece on Islamic banking that had been written until that time.[205]

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[203] See chapter 2 for a more detailed explanation of the historical context behind the establishment of the Dubai Islamic Bank and the Islamic Development Bank.

[204] For the feelings, motivations and ideas of Sami Hammoud as well as for the historical incidents about the establishment of the Jordan Islamic Bank see Abdullah Abd al-Majeed al-Maliki, *Al-Bank al-Islami al-Urduni*, (al-Dustour al-Tijaria, Amman, Jordan, 1996).

[205] For a translation of Hamoud's PhD, see Sami Hamoud, *Islamic Banking* (London: Arabian Information Ltd, 1985).

After finishing his PhD, Hamoud began feeling out-of-place at the National Bank and started actively advocating for the establishment of an Islamic Bank in Jordan. The idea was still new and seemed risky from the perspective of other bankers. When Hamoud took his idea to Abd al-Majeed Shoman, the head of Arab Bank, Jordan's largest and most well-respected bank, the latter was unwilling to invest any of his own resources to work with Hamoud in turning his idea of an Islamic bank into reality. Nevertheless Abd al-Majeed Shoman's children did establish the Islamic International Arab Bank (IIAB) in 1998. The IIAB quickly became Jordan's second largest Islamic bank and the only real competition to the JIB. However, in the mid-1970s, the Shomans' and other bankers were still not willing to take the risks inherent in establishing a new kind of bank that would work on principles very different from conventional banking practices. Initially, the Chief of Jordan's Central Bank, Mohammed Saeed al-Nabulsi, was also very hesitant about even allowing for the establishment of an interest-free bank in Jordan.

Hamoud was, however, strongly supported in Islamist circles and the Muslim Brotherhood began using its institutions and its connections in royal and governmental circles to help bring Hamoud's ideas into reality. Ishaq Farhan, the most prominent member of the Muslim Brotherhood in the National Consultative Council at the time, noted that the Islamists in that semi-parliamentary institution played an important role in advising the government to permit for the establishment of an Islamic Bank.[206] Sheikh Ibrahim Zaid al-Kilani, one of the most prominent leaders and Islamic scholars within the ranks of the Muslim Brotherhood, invited Hamoud to be a guest on a weekly television

[206] Interview with Dr. Ishaq Farhan, July 27, 2001.

show that Sheikh Ibrahim Zaid al-Kilani hosted. Hamoud ended up coming back for four consecutive weeks to discuss Islamic banking. The show played a tremendous role in popularizing the movement for the establishment of an Islamic Bank in Jordan.

The establishment of an Islamic Bank would require a special law that would have to be passed by the Council of Ministers. The Minister of *Awqaf* at the time, Kamil al-Shareef, was a prominent member of the Muslim Brotherhood. After the airing of Sheikh Ibrahim Zaid al-Kilani's show, Shareef adopted Hamoud's plan as his own and, according to Hamoud, became one of his closest and most trusted advisors.[207]

Shareef convinced Hamoud to establish a Preparatory Committee that would serve as an official organizational body calling for the establishment of an Islamic bank in Jordan. In a process that largely repeated itself later when the Islamic International Arab Bank was established in 1998, those working to establish the Jordan Islamic Bank in the mid-1970s worked to both appease and gain the support of the Islamists, while at the same time being very careful to remain independent of the Islamists and thus not seem to pose any threat to the political regime. In establishing the Preparatory Committee for the JIB, Shareef deliberately advised Hamoud to choose members who did not have strong political party or ideological affiliations. Shareef knew that if the bank was seen as too closely connected to the Muslim Brotherhood, or any other Islamic political party, it would be much more difficult to obtain a license.

Shareef nominated Yousef al-Mbeideen, a respected lawyer known for his piety and strong Islamic beliefs yet who was not connected to any Islamist party, to be the

[207] See interview with Hamoud as reported in al-Maliki, p. 25.

second member (along with Hamoud) in the Preparatory Committee. Mbeideen was highly respected in both governmental circles as well as in Islamist circles[208] and, with his legal skills, proved to be an adept partner to Hamoud. Hamoud and Mbeideen then jointly chose six other members to serve on the Preparatory Committee. While at least three of those members had some ties to the Muslim Brotherhood, none were considered political leaders of the movement and were known more for their technical skills and business acumen than their participation in the Islamic movement. Dr. Mohammed Saqr, a Harvard-graduated economist, was one of the most prominent economists in Jordan, and Sa'd al-Din and Misbah al-Zumeili were from a very wealthy business family that provided a substantial amount of economic support to the bank in its early years.

Hamoud's dissertation, the four-part television series on Islamic banking, and the establishment of the Preparatory Committee attracted attention in Saudi Arabia. The Saudi Prince Mohammad al-Faisal invited Hamoud to the Kingdom to discuss the bank and while there Hamoud also met Sheikh Saleh Kamel. Prince Mohammad and Sheikh Saleh Kamel were both interested in the idea of Islamic banking and promised Hamoud they would support his endeavor by investing the full 40 per cent of initial capital that Jordanian law would allow to be invested by non-Jordanians. Prince Mohammad also followed Hamoud's visit with a visit of his own to Amman, where he met the Jordanian Crown Prince Hassan. Prince Hassan responded favorably to the idea of an Islamic bank

[208] Mbeideen's ties to both governmental and Islamist circles is perhaps best exemplified by the fact that when he was elected as a member of the Lower House of the Jordanian Parliament in 1989 he was the only member to join both the pro-Government Constitutional Bloc and the Islamic Action Front bloc, a bloc made up of Muslim Brotherhood and independent Islamist deputies. See Tim Riedel, *Who is Who in the Jordanian Parliament 1989 - 1993*, (Freidrich Ebert Foundation, Amman, Jordan, 1993).

in Jordan and soon thereafter the issue was brought to the Council of Ministers. In May, 1977, the Council of Ministers agreed to permit the establishment of an Islamic Bank. However, an interest-free institution could not operate under the legal codes that governed how other banks operated, so the Council also asked the Preparatory Committee to prepare a blueprint for a Special Law that would detail the rules and regulations under which the Islamic Bank would operate.

The Preparatory Committee formed a *Fatwa* Committee including mostly Islamic legal scholars, but also some economists and lawyers responsible for devising a blueprint for the new law. As in the Preparatory Committee, there were some Islamists in the *Fatwa* Committee, including most notably Ibrahim Zaid al-Kilani, but again there seems to have been a deliberate attempt to choose *shari'a* scholars who were acceptable to both the government and the general masses and who were not too closely linked to Islamist groups or parties. The *Fatwa* Committee held 15 meetings from July 6 until September 11, 1977. During the meetings, the scholars discussed the kinds of contemporary financial transactions that were Islamically permitted. The Islamic scholars were not in full agreement on all the issues but after heated debates the *Fatwa* Committee issued a blueprint for a law that was approved by both the official Jordanian *Fatwa* Agency and later the Jordanian Central Bank and Council of Ministers, which passed a temporary law entitled "The Jordan Islamic Bank Law For Finance and Investment: No. 13, 1978."

The final law included some controversial matters that some claimed violated the *shari'a*. These issues influenced Prince Mohammad al-Faisal to back out from his earlier commitment to the bank,[209] but Sheikh Saleh Kamel quickly agreed to cover the full 40 per cent of the non-Jordanian capital that he and Prince Mohammad had earlier agreed to split among themselves.

In June 1978, a meeting was held by those who were committed to becoming initial shareholders in the bank. Interestingly, the meeting was chaired by Misbah al-Zumeili, who had ties to the Muslim Brotherhood. However, the Founders Committee that was elected at that meeting, like the earlier Preparatory Committee, had some Muslim Brotherhood members but no prominent leaders from the movement or other Islamist movements. The Founders Committee completed the remaining requirements for the Bank to become registered and obtain a license, including finding shareholders willing to invest JD4 million in initial capital. The bank became officially registered on November 28, 1978 and obtained a license permitting it to begin its work on March 26, 1979. The first *shari'a* advisor for the bank was Sheikh Abd al-Hameed Al-Saih, who had closer ties to the Palestine Liberation Organization than any Islamist group but who was well-respected by Islamists as well as the public at large.

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[209] Prince Mohammad never clearly stated the reasons for pulling out of the Jordan Islamic Bank. But being one of the most prominent sons of the recently assassinated King Faisal (assassinated in 1975) it could be politically controversial for him to be openly supporting an institution claiming to represent Islam that was involved in something that scholars asserted was violating Islamic principles. One controversial aspect of the 1978 Bank Law was over the Islamic legitimacy of the modern *murabaha* contract that Hamoud had developed in his book, but it is unlikely this would have led Prince Mohammad to withdraw from the bank, as these contracts were also widely used in other banks that Prince Mohammad sponsored. An even more controversial part of the Bank Law was article 22, which stated that the bank would be responsible for any losses that occurred for reasons of mismanagement or corruption. Some Islamic scholars feared that mismanagement could be interpreted too broadly, thus providing the kind of deposit guarantee that goes against the very essence of Islamic banking. For a copy of the Bank Law, see al-Maliki, *Al-Bank al-Islami al-Urduni*, Appendix 1, pp. 277-93.

In reviewing the role of Islamists in the establishment of the Jordan Islamic Bank, it is clear that they played an important supportive role. The importance of the backing of prominent Muslim Brotherhood leaders like Ishaq Farhan, Kamil al-Shareef, and Sheikh Ibrahim Zaid al-Kilani, as well as the financial support of the al-Zumeilis, cannot be underestimated. Their assistance, advice and lobbying on behalf of the bank, as well as their deliberate work through their mass media outlets to popularize the bank and give it legitimacy, probably played a decisive role in helping the bank gain early support and ultimately come to fruition. However, the Muslim Brotherhood itself recognized that being too closely linked to the bank, might lead to apprehension in some government circles, and thus it accepted playing a secondary role in the actual decision-making and leadership of the bank and never attempted to make the bank an institution of their movement. While many Muslim Brotherhood members were among the initial shareholders in the bank, they did not constitute a sizable enough portion to control General Assembly votes nor does it appear that they ever tried to use their votes to support any Brotherhood or other Islamist agenda.

When the Islamic International Arab Bank (IIAB) was established in the late 1990s, the Islamists played a less central role. With the backing of the conventional Arab Bank, the IIAB did not need nor did they seek the help of Islamists in gaining the necessary governmental approval to become registered in 1997 and begin operations in 1998. Nor did the Islamists have any meaningful influence over the Banking Law of 2000, which restructured many aspects of banking in Jordan and included a major section that formalized the laws regulating Islamic Banks in Jordan.

The support of the Islamist leadership for the establishment of the IIAB did, however, prove important in helping the bank gain legitimacy. The Arab Bank, Jordan's largest and most well-respected bank, financed the establishment of the IIAB as an independent Islamic bank whose dealings were wholly separate from those of the conventional bank. While many Muslims were distrustful of an Islamic bank that was owned by a conventional bank, the IIAB was able to get the support of important segments of the Islamist leadership thus providing their bank with the legitimacy it needed to be recognized as a true Islamic bank. It was the two most notable international Islamic scholars linked to the Muslim Brotherhood, Yusuf al-Qaradawi in Qatar and Faisal Mawlawi in Lebanon, who wrote the most convincing *fatwa* stating that the financial transactions undertaken by IIAB were Islamically legitimate.[210] The leader of the Muslim Brotherhood in Jordan, Abd al-Majeed Thuneibat, also sent a letter of congratulation to the bank when it officially opened and Muslim Brotherhood leaders have taken the official position that the IIAB is a legitimate Islamic bank that should have the support and patronage of Islamists in the country.

THE ISLAMIST VIEW OF ISLAMIC BANKING IN JORDAN

From the time Islamic banks were first established in Jordan, political Islamists have been keen to ensure their success and have often looked to them as points of pride, especially during the years when the banks were doing well. Political Islamists pointed to the success of Islamic banks in their speeches and in numerous newspaper and

[210] Interview with Saud Abu Mahfudh, July 25, 2001.

magazine articles as proof that Islam was a complete way of life that could not be restricted to the merely spiritual realm and that it could also provide economic solutions to the country's problems. The success of such banks gave concrete weight to the assertions of the Islamists that Islam as a religion was suitable for modern times in all aspects of life.

This does not mean that the political Islamists have always been supportive of everything done by the Jordan Islamic Bank and the Islamic International Arab Bank. There are deep frustrations among Islamist leaders and even more so at the grassroots Islamist level regarding the inability of the Islamic banks to realize many of the expectations that had been set out for them. There is a feeling that the banks could do much more in terms of providing social services, such as interest-free loans to the needy or to students, and that they should concentrate their investments in areas that better promote Islam, such as Islamic schools, or what they see as national security interests, such as agriculture, while avoiding dealing with the West.

Dr. Mohammed Saqr, a member of the Muslim Brotherhood who served on both the Preparatory Committee and the Founding Committee of the JIB in the late 1970s and maintained close relations with the bank ever since, was himself very critical of the bank during a conference on investment opportunities in Jordan in the summer of 2001.[211] He noted that the bank was too traditional, not innovative enough and, most importantly, did not in any way serve the developmental role that it potentially could. He derided the

[211] Dr. Saqr served as a discussant during a roundtable discussion concluding the conference: Investment in Jordan: Opportunities and Prospects that was held in the Amman Chamber of Commerce on July 17-18, 2001. The conference was sponsored by the Middle East Studies Center.

bank for investing outside Jordan rather than fulfilling its responsibilities toward helping Jordanian development and noted that the bank had never even come close to fulfilling the early hopes that it could serve a developmental role similar to the role played by German banks, or even Bank Misr in early twentieth-century Egypt. Saqr noted that, while Bank Misr was a conventional bank, its founder Talaat Harb had some Islamic inclinations and that those inclinations led him to use his bank to help develop and industrialize Egypt, an Islamic responsibility that Saqr noted was just as important as the legalistic prohibition of interest.

Jamil Abu Bakr, the spokesman for the Jordanian Muslim Brotherhood, noted that while the Muslim Brotherhood continued to support both the JIB and the IIAB, the group hoped the banks would do much more in terms of helping to industrialize Jordan.[212] He noted that the banks had not adequately fulfilled their role of undertaking innovative studies and research in the fields of Islamic economic and financial practices. Ali Abu Sukur, a prominent member of the Muslim Brotherhood and the General Secretary of the Jordanian Engineers Association, criticized the JIB for not using its extensive resources to buy land and ensure the country's agricultural resources remained in Jordanian hands.[213] Saud Abu Mahfudh, another prominent leader of the Muslim Brotherhood and the editor of Jordan's Islamist newspaper *al-Sabeel*, said that both the JIB and IIAB failed to play any social or developmental role in Jordan whatsoever and that while their activities were not forbidden – they did not deal in interest – they were not really true

[212] Interview with Jamil Abu Bakr, July 23, 2001.
[213] Interview with Ali Abu Sukur, July 25, 2001.

“Islamic” banks because they did not fulfill any other Islamic conditions besides the prohibition of interest.[214]

One of the best references for how political Islamists viewed the JIB during the banks halcyon years in the late 1980s and early 1990s is the 1990 doctoral dissertation of Ramadan Shallah, who, a few years after he wrote the dissertation, became the leader of the Palestinian Islamic *Jihad* movement. Shallah was very critical of the JIB for not providing enough social services and for not undertaking its developmental responsibilities. He was also critical of some managerial aspects of the bank, especially the fact that the bank at the time had only one *shari'a* advisor, rather than a *shari'a* board or committee, and that the board of directors of the bank could at any time appoint or dismiss the advisor, whose salary was also set by the same board. Shallah pointed out that such a status threatened the independence of the *shari'a* scholar to give correct judgments without undermining his own position.[215]

Despite his criticisms, Shallah went out of his way to show how the bank was successful and was playing an important role in helping Jordan solve some of its major economic problems. Jamil Abu Bakr, while criticizing some aspects of the bank, also acknowledged that the bank was in general doing a good job and that the dreams many Islamists had for the bank were perhaps unrealistic under the circumstances. The main thesis of Shallah's dissertation echoed this sentiment. He ultimately concluded that the difficulties the bank was facing were the result of governmental restrictions that had

[214] Interview with Saud Abu Mahfudh, July 25, 2001.
[215] Since Shallah's dissertation was written, the JIB has appointed a three-member *shari'a* Committee. Members of the Committee however can still by appointed or dismissed by the bank's board of directors at any time and the board still sets their salary.

established what he called “a hostile and unencouraging environment” that put the bank at a severe disadvantage with respect to conventional banks.

A decade after Shallah completed his dissertation Islamists had become less forgiving of the bank’s shortcomings. In looking at the poor performance of the JIB in the mid to late 1990s and early part of the new century, Islamists are now more likely to blame mismanagement at the bank itself than governmental restrictions on Islamic banking activities. Abdul Lateef Arabiyyat, the leader of the Islamic Action Front Party, said that his party had worked to pressure the Central Bank to deal with Islamic banks in a manner that would be less discriminatory but acknowledged that the major reasons for the bank’s poor performance lay not in governmental dealings, but with mismanagement, lack of expertise and lack of vision by the bank itself.[216] Arabiyyat said that the bank dealt with its customers and depositors in a less professional manner than other conventional banks.

A frustrated Islamist small businessman echoed these sentiments, saying that the JIB took its customer base for granted and treated them poorly.[217] The businessman said that the only reason Islamist businessmen use the JIB is because they consider other banks forbidden Islamically and that loans from the JIB always end up much more expensive than loans from conventional banks. The businessman said the central problem with the JIB was much more with their administrative shortcomings and

[216] Interview with Abdul Lateef Arabiyyat, July 27, 2001.
[217] Interview with a small businessman who is a member of the Muslim Brotherhood but asked to remain anonymous. The interview was conducted in Amman, Jordan on July 4, 2001.

mismanagement than with any state laws, regulations or restrictions hindering Islamic financial practices.

Political Islamists are not the only ones to complain about the administrative shortcomings and mismanagement at JIB. The general perception of the JIB within Jordanian society has become very negative since the mid-1990s. The belief that the bank uses an Islamic veneer to coerce Muslims into dealing with it is widespread and most non-Islamist Jordanians asked about the bank asserted that it takes and gives interest under the guise of different names. Islamists and non-Islamist Jordanians were very critical of the high mark-ups charged by the bank, the bank's unwillingness to engage in any even remotely risky ventures, and the relatively low "profit" margin the bank returns to customers.

One major difference between Islamists and non-Islamists, however, is in the general view of who controls and manages JIB. Many non-Islamists assume that the bank is an institution of the Muslim Brotherhood; while Islamists are very quick to point out that the JIB is in no way connected to their movement. Islamists now recognize that association with the bank carries more negative than positive baggage and that while they will continue dealing with, advising and working for the success of the bank, they want to make it clear that the bank's shortcomings are due to the human faults of its managers and not to the Islamic Movement or to the inability of Islamic economic principles to work in the modern world.

Many Islamists were quick to point out that while the bank itself did not have any political affiliation, it historically had many more business dealings with the Palestine

Liberation Organization than it did with the Muslim Brotherhood or any Islamist groups. Saud Abu Mahfudh noted that many top administrators of the JIB were or had earlier been members of Palestinian nationalist groups such as Fatah and the Popular Front for the Liberation of Palestine (PFLP), while none of them were members of the Muslim Brotherhood. He noted that while Musa Shehadeh, the general manager of the JIB since 1982, had become a devout Muslim who prayed regularly, he had earlier been a member of the radically secular PFLP. Saud Abu Mahfudh pointed out that, in the early years of the bank, the JIB did not hire any known member of the Muslim Brotherhood, even for minor clerical positions.

Many Islamists were also very critical of the JIB's largest stockholder, the Saudi Sheikh Saleh Kamel. While some Islamists noted that Sheikh Saleh Kamel is a generous benefactor who has been willing to support the building of Mosques and other charitable causes, others asserted that he was only interested in profit and were quick to point out that a famous satellite television station he owns is far from Islamic.

Just as there are conflicting views within Islamist circles about the JIB, there are conflicting views about the only other Islamic bank in Jordan, the Islamic International Arab Bank (IIAB). While some Islamists expressed wariness about the Islamic nature of the IIAB, others were supportive, noting that competition might force the JIB to become more efficient and innovative. Jamil Abu Bakr, the Brotherhood spokesman alluded to earlier, noted that, while some members of the Muslim Brotherhood were against the IIAB on the grounds that it was too closely linked to a conventional bank and thus that the source of its money and the methods with which it invested depositors' funds was suspect, the Muslim Brotherhood as an organization encouraged its establishment and believed that competition would be good for Islamic banking in general. Saud Abu Mahfudh, who has worked extensively with both the JIB and the IIAB, noted that the IIAB was much more professional and easier to work with than the JIB. Ali Abu Sukur said most of the JIB's shortcomings would probably be solved if there was true competition in Jordan for the Islamic banking market, his only reservation being that the IIAB was still not trusted by most Islamists, or Muslims in general, and thus did not represent real competition.

The Islamist view of Islamic banking in Jordan is complex. The frustrations about the mismanagement, administrative shortcomings, lack of innovation and unprofessional conduct of the JIB are deep and real but, as Jamil Abu Bakr pointed out, they are perhaps expressions of the unrealized and unrealistic expectations many Islamists had of the bank. Islamist leaders with a more acute understanding of the political realities in Jordan were quicker to find excuses for the bank than many of the grassroots Islamist cadres and Islamist businessmen whose dealings with the bank on a personal level had increased their misgivings. Ishaq Farhan said that, despite their shortcomings, the Islamic banks in Jordan continued to be appreciated by Islamists for the alternative to conventional banking practices that they were providing, and that one or two relatively small banks could not be expected to play a more political or developmental role than they already were. While Islamists in Jordan are quick to criticize some specific aspects of the JIB and the IIAB, they are also quick to defend the general principles that govern how the Islamic banks undertake financial transactions and they continue to be optimistic that the banks will overcome their problems.

THE ISLAMIST ECONOMIC AGENDA

Islamists in general recognize that banking and finance is only one aspect of the larger economic questions facing Jordan. While they would prefer Islamic banks that more actively worked for larger Islamic economic principles and undertook their business in a more professional and efficient manner than is the current case with the Jordan Islamic Bank and International Islamic Arab Bank, they also acknowledge that, in the absence of other conditions and policies, the banks cannot be expected to fulfill the larger goal of implementing a comprehensive Islamic economic agenda. However, Jordanian Islamists also concede that they themselves have not done enough to define what exactly that agenda entails.

Jamil Abu Bakr, the official spokesman for the Jordanian Muslim Brotherhood, acknowledged that economic affairs and policies are an area in which the organization remains weak. Saud Abu Mahfudh, the editor of Jordan's main Islamist newspaper and a leading member of the Muslim Brotherhood, recognized that the lack of a clear economic vision remains a major shortcoming of the Muslim Brotherhood in Jordan. He asserted that Islamists tended to shy away from discussions about economics, seeing economic policy-making as a "dirty job" that bordered on Islamically-prohibited areas. Musa Hantash, a Jordanian businessman who is a member of the Muslim Brotherhood, bemoaned the fact that Islamists did not play a larger role in working to build up the

Jordanian economy.[218] Hantash represented the views of many young Islamists frustrated with the leadership of the Brotherhood for not having any well-thought-out economic plans, or for using their influence in Parliament and in civil society to effect important economic change. Hantash noted that Islamists hardly ever even talked about economic issues, much less worked out plans to solve the various economic problems facing Jordan.

What the Muslim Brotherhood and other Jordanian Islamist groups have offered by way of economic policy is little more than a populist agenda. Islamist members of Parliament and official statements from Islamist groups have opposed all IMF reforms, asserted that corruption is at the root of all the country's economic problems, called for a breaking-off of the ties of dependence with the West and all economic relations with Israel, and, occasionally, called for the Islamization of the economy without really detailing what that means.

By far the most detailed outline of an Islamist economic agenda for Jordan can be found in the political platforms that the Islamic Action Front Party (IAF) releases before each of the parliamentary elections in which it puts forth candidates.[219] As Nathan Brown has pointed out, it is during the election campaign, that Jordan's Islamists – who have

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[218] Interview with Musa Hantash, July 25, 2001.

[219] The platforms all under the title: *Al-Burnamij al-Intikhabi li-Murashihee Hizb Jabhat al-Amal al-Islami li-Intikhabaat al-Majlis al-Niyabi al-Urduni* (The Electoral Platform for Candidates of the Islamic Action Front Party for the Elections to the Jordanian Parliament) were published in 1993, 2003 and 2007. The IAF boycotted the 1997 and 2010 parliamentary elections.

never really faced the possibility of actually ruling - are compelled to put together a platform that provides a more specific set of positions than it normally provides.[220]

In the introduction to the 1993 platform, the IAF describes the achievements of the Islamists in the previous parliament which was elected in 1989, the first parliamentary elections since 1967 and an election in which Islamists had won more than 40% of the seats. The 1993 platform noted that in the economic realm the Islamists played a decisive role in the decision to form a parliamentary committee to monitor administrative and financial corruption by government officials and in the passage of a number of laws, such as one forgiving the interest on the debts of small farmers and another lowering custom duties on the cars of Jordanians returning to Jordan from the Gulf countries. The introduction also mentioned that the Islamists had taken a strong stand opposing tax increases and price-hikes on subsidized goods.

The introduction to the 2003 platform (which came after the party's decision to boycott the 1997 elections) discussed the rationale the party uses to decide whether to run candidates or boycott an election. The introduction listed a number of objectives that the movement had and noted that the decision of whether to participate or boycott an election was based on an analysis of what would best help them achieve those larger objectives. The only objective that was even remotely connected to economic matters was one that stated their desire to "put an end to administrative, financial and moral corruption." The

[220] Nathan Brown, *Jordan and its Islamic Movement: The Limits of Inclusion?*, (Carnegie Endowment for International Peace, No. 74, Nov., 2006) p. 9.

2007 platform had a similar introduction but did not mention corruption and for the first time mentioned their desire to help with "development."

After the Introduction, the 1993, 2003, and 2007 IAF Platforms all included a section on legal changes the party would attempt to bring about in the upcoming parliament and each platform included a statement asserting that they would "work to reevaluate financial legislation to ensure the banning of interest and other Islamically forbidden practices and would orient policies toward the Islamic *shari'a*."[221] The platforms then listed the party's positions in a number of policy arenas. All three platforms included a statement under "Housing Policies" which stated that they would "Encourage Housing contracts that are in accordance with the Islamic *shari'a* and exempt those who have benefitted from Housing Projects from paying interest charges." The 1993 platform had a section entitled "Trade and Industrial Policy" which was dropped from the 2003 and 2007 platforms. The first policy proposal under that section in the 1993 platform called for: "providing governmental support to the existing Islamic financial institutions and working to increase their number and develop their services so that they will become models for other financial institutions."

Most of the party's economic agenda was explained under a section that was included in all three platforms entitled "Economic, Monetary, and Financial Policies." In the 1993 and 2003 platforms, the first point in that section called for: "Amending

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[221] The wording in the three platforms is slightly different and the quote here is from the 1993 platform. While much of the platform remained the same in all three elections, the section concerning legal changes did see a number of changes over the years and the fact that the statement calling for forbidding interest remained in all three is significant. The 1993 platform included 18 points, the 2003 platform 13 points and the 2007 platform 8 points – one of which was the call to forbid interest.

financial and economic legislation in accordance with the Islamic *shari'a*." This statement was dropped from the 2007 platform. Much of the remaining platform remained nearly identical in all three years. All three platforms stressed working for the establishment of a pan-Arab Common Market and Arab economic integration, while calling for resistance to all economic programs aimed at normalizing relations with Israel and monitoring all foreign investment to ensure foreigners did not gain a hold over any strategic Jordanian industries. The platforms further supported providing governmental incentives for investment in industry, agriculture and other economic sectors.

The Islamists' concern for the poor was shown in a number of points calling for better-distributed developmental programs throughout Jordan, working to cure poverty at its roots by providing training and developmental funds to those in need, establishing a national strategy to overcome the problem of unemployment, increasing welfare funds, increasing the salaries of governmental workers and putting a halt to price hikes on subsidized goods. The Islamists also showed a strong concern for lowering the trade deficit, the national debt and the current accounts deficit. The platforms further called upon the government to increase its gold and foreign currency reserves as a means of stabilizing the Jordanian dinar and lowering inflation.

There were also a number of points aimed at decreasing corruption, such as one calling for increased monitoring of how governmental ministries and agencies spent their money, another for increasing the power and scope of the governmental accounting bureau, and one for placing the budgets of all public sector institutions under parliamentary scrutiny. Throughout the platforms, the Islamists also called for policies that might provide a cultural cure to some of Jordan's economic problems. One article, for example, called for "spreading awareness of Islamic values against excessive consumerism, for encouraging productivity, and for guiding consumption."

In addition to the political platforms, statements issued by the IAF since its founding in 1992 also provide insight into the depth of the party's understanding of economic issues and the kinds of economic policies promoted by Islamists. The relative lack of concern Islamists have shown for economic matters is underscored by the fact that out of more than 100 statements issued by the party in the first ten years after its inception in 1992 only a handful dealt even remotely with economic issues.[222]

The IAF was very critical of the peace process with Israel in both its political and economic aspects. One statement, dated October 31, 1994, condemned the Israeli participation in a Middle East Economic Conference being held in Morocco. The statement called upon the Arab nations to avoid dealing with Israel, and to work with each other in promoting Arab economic integration in a manner that would solve the economic problems of the region.

The IAF was also extremely critical of an American-Jordanian-Israeli agreement that allowed for duty-free access to the United States market for any goods manufactured in special Qualified Industrial Zones (QIZs) in Jordan, in which there are no customs duties on imported materials and at least 8 per cent of the industrial inputs come from Israel. The IAF was also critical of a Special Economic Zone established in Aqaba in

[222] The statements were taken from a detailed analysis of all statements issued by the IAF from 1992 to 2002. The statements are all kept in "The Binder of Statements and Official Correspondence of the Islamic Action Front Party" that is kept at the IAF Party Headquarters in Amman, Jordan.

2000, and in a statement dated July 24, 2000 the IAF complained that Israeli and Western investors could exploit the zone. The statement attempted to refute governmental arguments that the free trade zone would solve Jordan's economic problems and provided counter-arguments explaining how the zone would in fact exacerbate existing problems and lead to new ones.

An IAF statement dated May 14, 1996 dealt with a number of economic issues. The statement was critical of a rise in the price of water and electricity, and called for the establishment of a tangible plan to solve the problems of unemployment and poverty. A similar multifaceted statement dated January 17, 2000 was critical of governmental privatization policies, contending that only the most profitable state enterprises were being sold and that no tangible benefits were accruing from the sales, which, the statement asserted, were also allowing for Israeli and foreign penetration into important Jordanian companies, including most notably the Jordanian Water Authority. The statement was also critical of an increase in sales taxes and educational fees. A few other statements criticized the government for increasing taxes or fees. An earlier June 16, 1993 statement was very critical of price hikes and an expansion of the consumption tax to cover more goods, and a July 3, 2001 statement expressed the IAF's opposition to a governmental plan to sharply increase the price of fuel in response to demands from the World Bank.

The Islamist party's statements and actions concerning economic issues since 2002 have remained consistent with their earlier positions. The most prominent economic issue that the IAF was concerned about in the 2003-2007 Parliament was fuel price increases and in 2006, IAF members of parliament took the lead in denouncing those increases and leading public marches calling for a rollback.[223]

The IAF website lists every statement the party has made since late 2009. Of the 252 statements the party made in 2010, there were numerous statements on foreign policy issues (mostly concerning Palestine), a number of statements criticizing violations of human and civil rights and numerous calls for political reform and more political rights, but only a handful dealing with economic issues.[224] The economic issues were all criticisms of the rise in prices of goods, most of which were subsidized. An August 10 statement called upon the government not to increase subsidized fuel prices, then an August 14 statement as well as a Nov. 28 statement criticized the government's decision to increase fuel prices by 4%. A Sept. 19 statement had also criticized the decision to increase the price of subsidized livestock fodder and a Sept. 21 statement said that governmental policies were responsible for the huge increase in the price of vegetables.

Economic issues were notably absent from an April 12 statement that outlined the agenda for a General Assembly meeting of the party leadership. The most notable sentence dealing with the economy in that statement asserted that the party would "support the national economy and participate in its independence and growth while giving special concern to the agricultural sector." Another sentence that was not solely related to the economy asserted that the party would "encourage and put into effect all forms of Arab and Islamic coordination."

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[223] Nathan Brown, *Jordan and its Islamic Movement: The Limits of Inclusion?*, (Carnegie Endowment for International Peace, No. 74, Nov., 2006) p. 13.
[224] IAF website, http://jabha.net, accessed Jan. 1, 2011.

The most comprehensive economic statement on the IAF's website was an October 24, 2009 statement which asserted that the country's rising deficit and debt were early indicators of the country again falling into the kind of crisis it had suffered from in the late 1980s and calling upon the government to cut non-essential spending, better manage their finances, end corruption, pass a new income tax law that would increase rates for the wealthy while lowering them for the needy, and consolidate governmental programs and agencies in a way that would make them more efficient. At the same time, the statement said the government should not cut subsidies needed by the poorest elements of society and should continue and even increase stimulus programs aimed at ending unemployment and poverty.

IAF officials acknowledge that the number of their statements that deal with economic matters are almost negligible. Ahmad Tannash, the IAF board member with the strongest economics background, recognized that during the 1990s Islamists in the Jordanian parliament had almost no input and, more often than not, did not even take a stand on the many economic issues discussed in parliament.[225] Jamil Abu Bakr, a member of the IAF Administrative Board, as well as the spokesman for the Muslim Brotherhood, said that Islamists felt that the real solution to the major economic problems facing Jordan lay in political rather than economic remedies.

He listed the major economic problems as corruption, poverty, unemployment, high taxes, a large income-and-wealth gap, and no consistency in government economic policies. He was especially vocal about corruption, noting that the problems of bribery,

[225] Interview with Ahmad Tannash, July 29, 2001.

nepotism and embezzlement were rampant. The need for connections to get any matter through Jordan's bureaucracy was another major problem he addressed, as was the existence of commercial monopolies for a number of important goods. To solve those problems, Jamil Abu Bakr said the Islamists worked to expose and bring an end to all forms of corruption, allow for more democratic freedoms and demand more transparency in governmental and business dealings.

To be fair, the problems enumerated by Jamil Abu Bakr and repeated by other Islamists are real problems in Jordan and the political remedies he put forward would likely do a great deal to begin tackling them. However, as the Islamists themselves concede, they have not adequately addressed specific economic issues and their inexperience in economic affairs has been evident in their lack of action in Parliament. While more transparency in government affairs and an end to corruption would likely lead to major improvements in Jordan's overall economy, it is far too simple to assume that an increase in democratic freedoms would by itself bring about more just economic policies that could solve the problems of unemployment, poverty and the huge gap between the rich and poor. As by far the largest political party in Jordan, the IAF has a responsibility to better study the specific economic problems facing Jordan and to begin offering detailed economic solutions to those problems. The past failure to fulfill that responsibility has had a detrimental effect on their legitimacy.[226]

[226] For a more in-depth analysis of the shortcomings of both the Muslim Brotherhood and the Islamic Action Front in the area of providing modern realistic solutions to problems facing Jordan and how that has effected their legitimacy see: Hani Hourani, ed. *al-Harakaat wa-Tandhimaat al-Islamia fi-l-Urdun*, 1996 (al-Urdun al-Jadid Research Center, Amman Jordan) pp. 283-287.

ISLAMIST ECONOMIC ACTIVITIES IN JORDAN

Outside the activities of the Islamic banks in Jordan, a growing number of grassroots, usually young and well-educated Islamists are undertaking a number of their own economic activities in accordance with Islamic principles. These activities constitute an increasingly important segment of Jordanian civil society and have the potential to effect gradual but real political and social change in the country. These grassroots Islamists are distrustful of the government and its corrupt practices, are frustrated by the Islamic banks and their timidity, and are often impatient with the slow pace and seeming lack of awareness by the political leadership of the Muslim Brotherhood and other Islamist groups.

The most significant arena for such activities is in Jordan's professional associations, most notably the Jordanian Engineers Association. When Islamists decisively won the 1990 elections for the leadership position of the Engineers Association, it was already the largest of Jordan's professional groups and had assets of about $10 million.[227] In less than a decade, the Islamists had increased its assets to nearly $70 million, which was partially invested in stocks and partially used to provide financing for engineers who wanted to buy land, houses or cars. Most significant for our purposes is that all such financing, as well as the other kinds of financial transactions undertaken by the Association, is done in strict accordance with Islamic principles,

[227] For general information on Jordan's professional associations see Hani Hourani ed. *Professional Associations and the Challenges of Democratic Transformation in Jordan*, 2000 (al-Urdun al-Jadid Research Center Amman Jordan).

though it is done almost completely outside the purview of the official Jordanian Islamic banks.[228]

The establishment of a businessman's association in 1997 that brought together seventy-nine Islamist businessmen with the explicit goal of using their economic and organizational power to influence political, social, and cultural change, marks another important kind of activity that grassroots Islamists adopted.[229] The establishment of the *Jami'yat al-Rakha*, or Businesmen's Prosperity Association, in Jordan occurred after a visit to Jordan by members of Turkey's MUSIAD organization.[230] The MUSIAD is a powerful Islamist business association in Turkey whose success and economic power is believed to have played an important role in helping an Islamist political party in that country. Like the Engineers Association, many of the businessmen in *Jami'yat al-Rakha* have become disenchanted with the Islamic banks in Jordan. While members of *Jami'yat al-Rakha* are more likely to use the Islamic banks than other Jordanian businessmen, many of them privately finance their business activities without seeking bank loans and others have resorted to using conventional banks out of frustration with the shortcomings of the Islamic banks.

Ali Abu Sukur, a founding member of the *Jami'yat al-Rakha* Association, said the first goal of the group was to form an organization that could begin influencing the elections for different Chambers of Commerce in Jordan. While Islamists control nearly all the professional associations in Jordan, they have never fared well in Chamber of

[228] Interview with Ali Abu Sukur.
[229] See Membership Directory of the Jami'yat al-Rakha' Li-Rijal al-A'maal.
[230] Interview with Musa Hantash, a member of the Jami'yat al-Rakha in Jordan.

Commerce elections. Ali Abu Sukur noted that business in Jordan currently plays a very marginal role in influencing Jordanian politics. Most business owners, fearful of governmental retaliation, try to keep their businesses separate from politics and do not try to use their capital to influence the larger political issues facing the country.

Ali Abu Sukur, in addition to being the General Secretary of the Jordanian Engineers Association, also heads the Anti-Normalization Committee that calls for exposure and boycotting of any Jordanian professional or business interest that deals with Israel. His activities with the committee have placed him in direct opposition to policies of the Jordanian king and royal family, and he has suffered because of that with imprisonment and harassment. Ali Abu Sukur is thus a living example that attempting to use one's professional or business power to influence politics can be dangerous in Jordan; but he and the other members of *Jami'yat al-Rakha* believe that business and capital have responsibilities toward their country. Ali Abu Sukur noted that all businesses have a strong interest in political stability and that such stability can best come about through a more democratic polity. *Al-Rakha* thus aimed to influence Chamber of Commerce elections in such a way that they could begin transforming Chambers of Commerce in Jordan into mouthpieces for increased democratization of the country.

Musa Hantash, another founding member of *al-Rakha*, pointed out that the association has not even come close to achieving the ambitious goals it set out for itself. *Al-Rakha* remains very small because even the most Islamically-minded businessmen are scared that joining the group and becoming openly labeled as Islamist could lead to governmental harassment in a country in which governmental connections and favors are indispensable for the success of any business venture. Saud Abu Mahfudh observed that there were thousands of Islamist businessmen in Jordan, yet less than one hundred had the courage to join *al-Rakha* because of such fears. Hantash noted that a few large Islamist businessmen could have marginal influences on some minor political affairs but that such influences came about through their own personal contacts with members of the royal family or government officials, and not through the organizational activities of business associations or Chambers of Commerce. It is only such organizational power, however, that could lead business and capital to play the kind of political role in transforming the polity that Ali Abu Sukur and other Islamists feel is necessary.

Another phenomenon that perhaps more than anything else underscores the shortcomings of the Islamic banks in Jordan is the huge informal economy in Islamic finance. Networks of support exist throughout Jordan in which extended families, neighbors, friends and co-workers help each other purchase homes, jointly invest their money in various ventures, or undertake other kinds of financial transactions in strict accordance with Islamic principles. Most of those that use such networks are uncomfortable using conventional banks, but at the same time have become frustrated with the unwillingness of the Islamic banks in Jordan to provide the kind of long-term financing needed to purchase homes or to help launch new businesses, as well as the disappointing returns the banks provide on investments or deposits. While the mutual trust and close ideological ties found among Islamists encourage the formation of such networks in Islamist circles, similar networks can also be found among other Muslim

Jordanians who, while not sharing Islamist ideological affinities, remain committed to abiding by the Islamic prohibition on taking or using interest.

The extensive economic activities of Islamists outside the structure of Islamic banks, whether through unofficial networks, control over the funds of professional associations, or in terms of their business and organizational strengths, in addition to their disappointment with the Islamic banks that currently exist in Jordan has led some Islamists to consider setting up their own Islamic bank in the country. Ali Abu Sukur noted that the Engineers Association had in the past considered opening its own bank to take over and ultimately expand the extensive financial assets under its control. However, he recognized that it would be nearly impossible for the organization to obtain a license, both because the Central Bank was convinced that there were already too many banks in Jordan and were not keen to provide new licenses, and because the government would likely prohibit Islamists from having their own bank.

Jamil Abu Bakr said that the Muslim Brotherhood itself had also considered opening a bank but that the organization did not have the initial capital required. He also noted that the government often removed Islamists from local *zakat* committees, fearing that controlling *zakat* funds could give the Islamists too much power, and thus the idea of an Islamist-run Islamic bank would likely find very strong opposition in some government circles.

The widespread feeling by Islamists that they would not be allowed to establish their own bank, the fear by many Islamist businessmen to join an Islamist business association, as well as numerous cases of actual governmental harassment of those who attempt to use their economic or institutional powers to influence political change, underscore the reality that the state remains dominant over civil society in Jordan and that private-sector activities are still not powerful enough to challenge state authorities on sensitive political topics. At the same time, however, the actual formation of the businessmen's association and continued activities by professional associations indicates that there is a growing societal awareness that their activities can lead to meaningful change and that there are a growing number of people willing to sacrifice some of their own interests to help bring about such change.

ISLAMIST RELATIONS WITH THE ISLAMIC BANKS IN JORDAN

As mentioned earlier, the Muslim Brotherhood played a decisive role in providing needed support for the initial establishment of the Jordan Islamic Bank. The bank authorities, however, later took on the delicate balancing act of deliberately distancing themselves as much as possible from the Islamists, so as not to bring upon themselves governmental scrutiny, while at the same time maintaining enough legitimacy in Islamist eyes to keep their business and moral support.

The Islamic bankers were especially wary of exposing any ties whatsoever between their banks and political Islamists. Bakr Rehan, the executive manager for the Planning and Organizing Department at the Jordan Islamic Bank (JIB), discounted any ties between JIB and political Islamists and said that the bank had never requested and had received only marginal help from Islamists in Parliament, despite the bank's concern about a number of laws and regulations that had recently been debated in that body.[231] Nihad Maraqa, the Manager of Planning for the Islamic International Arab Bank (IIAB), also asserted that IIAB was a business with no political agenda.[232] While he noted that the bank played an important social role in Jordanian society, he was insistent that Islamic banks had no direct ties to Islamist political groups and certainly could not play a mediating role between governments and Islamic movements. Like Rehan, he said that the bank had never requested nor did they expect to get much assistance from Islamists in parliament.

Despite the insistence by bank managers that there is absolutely no relationship with Islamist movements, there are some ties that the Islamists were more willing to allude to than were the bank managers. First of all, the vast majority of members of the Islamic Movement who have money in a Jordanian bank have deposited it in the Islamic banks, not necessarily because of their support for the institutions themselves but for the basic reason that they believe it is the only Islamically legitimate means to deposit money. Furthermore, nearly all of the Islamist-run businesses in Jordan use only Islamic banks for all of their financial dealings. While Musa Hantash stressed that the level of influence the Islamists played over JIB policies was minimal, he noted that Islamist-run businesses provided a huge percentage of JIB's overall clientele and perhaps had the potential to begin influencing the JIB if they attempted to do so in an organized fashion.

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[231] Interview with Bakr Rehan, Executive Manager for the Planning and Organizing Department at JIB, June 18, 2001 in Amman, Jordan.

[232] Interview with Nihad Maraqa, the Manager of Planning for the Arab Islamic Bank, June 19, 2001 in Amman Jordan.

While the Islamic banks are adamant that they have no ties to political Islamists, they do recognize the importance of Islamic movements and try not to alienate them. It was only after the establishment of the IIAB in 1998 that the JIB - after 20 years of existence - set up its own marketing department. Yet even without a marketing department for most of its existence, the JIB witnessed extremely fast growth during its first decade, largely on the basis of the political Islamists' ability to popularize the idea that any kind of banking interest amounted to forbidden *riba*, an idea that government officials throughout the Arab world, sometimes with the support of Islamic scholars close to government circles, often try to debunk. Ishaq Farhan, the former leader of the Islamic Action Front Party, pointed out that Islamic scholars associated with the Muslim Brotherhood had passed clear *fatwas* asserting that it was forbidden to deal with conventional banks and they always insisted that Muslims deal only with Islamic banks.

This kind of support from the Islamic Movement gives Islamic banks a degree of legitimacy and a guaranteed clientele that they could easily lose without such backing. Islamic banks recognize that the Islamists could have a profound impact on their ability to retain customers by such simple things as harshly criticizing some aspect of the bank's activities, publicly asserting that the bank's methods were not in conformity with Islamic law, or even just ending their continued support and encouragement for the bank. Islamic banks thus recognize that their strength is in many ways affected by the strength of the Islamic movements and there are a number of indirect means the banks employ to maintain the continued support of the Islamists.

While in its early years the JIB may have gone out of its way to avoid hiring Islamists, that seems to have changed. Many young Islamists, hopeful of jobs with Islamic banks, are now studying economics and finance - once subjects that Islamists avidly avoided. Even more significantly, when the JIB expanded its *shari'a* advisor to a 3-member *shari'a* board, it included two Islamists, one with ties to the Islamic Liberation Party and the second Sheikh Ibrahim Zaid al-Kilani, one of the leading figures in the Muslim Brotherhood. Musa Hantash pointed out that being known as a committed Islamist is often seen by JIB loan officers as a sign of honesty that could help them get business loans, sometimes on easy terms.

The JIB also spends hundreds of thousands of JDs a year on charitable contributions and donations to various Islamic causes,[233] many of which are linked to the Muslim Brotherhood. The project to which the JIB is most closely linked is the *Afaaf* Charitable Committee, which provides needy couples help in getting married. The Committee is headed by the former IAF Party leader Abdul Lateef Arabiyyat. Arabiyyat noted that the JIB donated JD5000 (approximately $7,500) to the *Afaaf* Committee annually in addition to providing every groom married with the assistance of the Committee with a JD100 gift. Even more significantly, the JIB provides hundreds of thousands of JDs annually through *Afaaf* as interest-free loans to grooms.[234] The JIB provided a total of JD21.8 million in interest-free loans in 2008 benefiting more than

[233] See Jordan Islamic Bank Annual Reports. In 2008, the JIB spent JD 340,000 (more than half a million dollars) in charitable donations, see 30th Annual Report, page 15.
[234] Interview with Abdul Lateef Arabiyyat. Arabiyyat noted that in the year 2000 alone, JD 400,000 in interest-free loans was provided from the JIB to grooms associated with the Committee.

19,000 citizens,[235] many of whom were members of the Muslim Brotherhood. The JIB has been a frequent donor to the Muslim Brotherhood-run network of Quranic schools in Jordan as well, providing about JD37,000 in direct contributions for Quranic memorization prizes and easy financing arrangements for the building of new Quranic schools in 2008 alone.[236] JIB also provided easy finance arrangements to projects of the Zarqa National University, a Muslim Brotherhood-run institution led by Ishaq Farhan.[237]

While the IIAB's links to Arab Bank provide it with a cushion of support most Islamic banks do not enjoy, it also recognizes the important role Islamists can play in the success or failure of an Islamic bank. Musa Hantash noted that perhaps as many as 80 per cent of Islamists are still distrustful of the IIAB because it is owned by a conventional bank. The IIAB has, however, benefited greatly from the support of the Muslim Brotherhood leadership.

When debates were raging in the mainstream Jordanian press about whether the IIAB could be considered a legitimate Islamic bank, the Muslim Brotherhood newspaper, *al-Sabeel*, clearly sided with the opinion that the bank was legitimate. When the IIAB returned the favor by placing ads in *al-Sabeel*, the JIB broke its long-running contract with the newspaper. *Al-Sabeel* now does most of its business with the IIAB.[238] It will be recalled that the two most notable international Islamic scholars linked to the Muslim Brotherhood, Yusuf al-Qaradawi in Qatar and Faisal Mawlawi in Lebanon, wrote the

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[235] JIB 30th Annual Report, page 16.
[236] Interview with Jamil Abu Bakr and 30th Annual JIB report.
[237] Interview with Ishaq Farhan.
[238] Interview with Saud Abu Mahfudh.

most convincing *fatwa* stating that the financial transactions undertaken by IIAB were Islamically legitimate.[239] A sign of how much IIAB recognizes the importance of the Muslim Brotherhood support is underscored by the fact that when the leader of the Muslim Brotherhood in Jordan, Abd al-Majeed Thuneibat, sent a letter of congratulations to the bank on its official opening, the bank had the letter enlarged, framed, and placed in the lobby of its bank headquarters.

CONCLUSION

This chapter has illustrated the many-faceted relationship between Islamic banks and the Islamic movement in Jordan. It is clear that, in Jordan, Islamic banks are organizationally distinct and have very few direct ties with the Islamic Movement, yet the two institutions have many interests in common and recognize that a stronger relationship could serve the needs of both. The main barrier to stronger ties is fears on the part of the banks that being too closely linked with a political opposition group could lead to governmental harassment. Thus, the state forms a barrier blocking what would be a natural tendency for the two to increase their levels of coordination and cooperation. If this barrier were removed and the political environment in Jordan opened up in the sense that the Islamists were allowed to compete against other political movements for real political power, rather than just seats in a constricted parliament, it is likely that there would be much closer ties between the Islamic banks and the Islamic movements.

The Islamic movement has acknowledged its own shortcomings in terms of providing concrete policy proposals in a number of realms, especially economics.

[239] Ibid.

Islamic banks, on the other hand, have been forced to deal for decades with the practical problems of implementing Islamic economic principles in the modern era. Further coordination with the Islamic banks would thus help the political Islamists better define their economic policy platform, something the Islamists would need if there were true political liberalization in Jordan.

Jordan is now facing major economic transformations, as increased globalization, the free-trade pact with the United States and entry into the World Trade Organization is forcing them to compete globally in a way they never had to in the past. Islamists have been critical of such moves toward globalization without being able to define a clear alternative. Islamic banks in Jordan and elsewhere however have been forced to deal with the more globalized world in concrete terms and have often devised strategies by which they can benefit from such trends through using Islamic economic and financial principles. If Islamists want to make the transformation from being a populist organization into being a serious political party with the experience and technical skills to lead Jordan in the modern era, while at the same time maintaining their strict adherence to Islamic principles in economic affairs, they will need the technical acumen and experience of the bankers.

On the other hand, a more liberal political environment is likely to strengthen the political Islamists to the extent that they could also provide much needed assistance to the financial Islamists, in terms of bringing about the kinds of legislative reforms that the financial Islamists need to overcome the very real problems and challenges they are currently facing. The fear of being too closely aligned with the Muslim Brotherhood has prevented Islamic banks from even seeking the support of Muslim Brotherhood parliamentarians for such simple things as changing laws that in effect tax goods purchased through Islamic banks twice,[240] or prevent Islamic banks from participating in a government-sponsored house mortgage refinancing company.[241] In a more politically liberal environment, it is likely that political Islamists would work very closely with the Islamic banks to ensure that the government provided the kind of legal and regulatory environment that would not only remove restrictions and hindrances faced by Islamic banks but also provide government sponsorship of the banks through such measures as using Islamic banks for the financial business of the state.

In addition to serving each other's needs, closer ties between Islamic banks and Islamic movements would have profound political consequences.[242] Again, to the extent that real political liberalization comes about, a scenario could be imagined in which Islamic banks increasingly serve the role of financial and political intermediary, relating Islamic political figures to Islamist-oriented businesses and investors. Such a role would tie the banks to political patrons in ways that could substantially reduce their information costs. High information and transaction costs are one of the greatest challenges facing Islamic banks and hindering their ability to compete fairly with conventional banks. It is

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[240] When someone wants to finance a purchase through an Islamic bank, the bank first purchases the good then resells it to a customer. Current Jordanian laws tax both transactions.

[241] This company was established in 1996 to help Jordanian banks provide long term housing finance to banks with mostly short-term deposits by channeling long-term funds – such as pension funds or insurance companies controlled by governmental agencies through Jordanian banks with the express purpose of providing housing finance.

[242] For a seminal piece that first hypothesized the notion that Islamic banks would benefit from a more liberal political environment in which Islamic movements could more freely advocate for them see Clement Henry, "Islamic Banks and Competitive Politics in the Arab World and Turkey," Middle East Journal, 44:2 (Spring, 1990).

possible that closer ties would thus greatly reduce some of the structural disadvantages the Islamic banks have with respect to conventional banks.

It is also likely that closer ties between Islamic political and financial actors would have a significant impact on the incentive structures of the political actors, leading them to lessen their demands upon the state, become more amenable to cooperation and coexistence with opposing ideological trends, and ultimately to provide stronger support for the democratization of society.

Thus, in the case of political liberalization, Islamic banks could play an extremely important role in mediating the transition of political Islamist groups from mass-based populist organizations into conservative, religious political parties in a multi-party system, similar to the Christian Democrats in Germany, or the Justice and Development Party in Turkey. The problem is that there is not a very big likelihood of political liberalization in the near future, especially in the new international and regional order that has been established in the wake of September 11, 2001. One major problem in the post-September 11th order is the increased scrutiny and targeting of Islamic banks, often labeling them the financiers of terrorism. The attempt to escape such a label has made Islamic banks even more wary of any dealings with Islamists. If this last problem can be avoided, the ties between Islamic banks and Islamic movements are likely to increase gradually in Jordan, even in the absence of political liberalization, because of increasing competition between the IIAB and JIB.

The existence of competition within the Islamic financial market has forced Islamic banking in Jordan to become more efficient, better managed and more innovative than it had been in the past. Competition has also forced the Islamic banks to compete for the large Islamist market, rather than take it for granted. As Musa Hantash pointed out, loan officers in Islamic banks had already been more likely to provide business loans to committed Islamists. With increased competition between the JIB and the IIAB, the banks became more innovative, and the higher level of trust the banks have in committed Islamists is likely to lead the banks to provide such clients with the more risky kinds of Islamic financial instruments. The first *istisna* contract in Jordan thus went to a committed Islamist to build an Islamic hospital. In competing for the Islamist market, banks will be likely to make more such concessions to Islamist demands in a way that, if it proves successful, will both financially empower the political Islamists while also making the Islamic banks more efficient by reducing their monitoring costs and providing them with new kinds of financial instruments.

The extent to which this takes place will depend on two factors, both relating to the Islamic movement: first, the level to which the Islamic movement can better organize itself and begin making use of its economic weight and strength in a more structured fashion; and second, the degree to which the Islamists can maintain a good enough relationship with the government and royal family to not be seen as too dangerous of a political threat. If these two conditions are met, the increased coordination and cooperation between Islamic banks and Islamic movements is likely to have important political effects even in the absence of increased political liberalization. In this more realistic scenario, Islamic banks can be expected to play an important role in mediating the transformation of political Islamists and making them into a more effective voice for democratization through the organization and mobilization of civil-society institutions and activities.

CHAPTER SIX: CONCLUSION

Karl Polanyi recognized the importance of culture, history, and institutions in the economic life of society.[243] In discussing the establishment of unified national markets that came about with industrial capitalism in Western Europe, Polanyi did not deny Marx's contention that the process was exploitative. But rather than focus on economic exploitation, Polanyi looked at the cultural context and found that the establishment of national markets detached the economy from its social base, creating widespread cultural alienation and removing people from the cultural framework that had previously constituted the matrix of their human existence and identity.

Polanyi's work has had a huge impact on anthropology. His theories led to the establishment of a new paradigm in anthropology called substantivism. Substantivists argue that the formalist neo-classical economics paradigm based on utility maximization and rational actors does not adequately explain the social and cultural context that plays an important role in the economy. Polanyi has, however, largely been ignored by economists and political scientists despite the fact that his work could provide important insights into the debate on society and the state, economic institutional change, and cultural politics.

One key concept of anthropological substantivism is that economies are embedded in both economic and non-economic institutions and that economic exchange is regulated by many of these non-economic social institutions, such as religion and

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[243] Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, (Boston: Beacon, 1944). Also see Gregory Baum, *Karl Polanyi on Ethics and Economics*, (Quebec: McGill-Queen's University Press, 1996).

government. According to this paradigm, any analysis of an economy without looking at these institutions will be flawed.

While Polanyi saw the importance of culture, he did not see it in the same way as Max Weber.[244] He did not believe that there were any cultural prerequisites to the establishment of certain political or economic institutions or that certain cultural traits were superior to others in the development of society. What he did believe was that for any kind of political or economic institutional change to be successful and enduring, it should be undertaken within known and developed cultural and social institutions.

In *The Great Transformation*, Polanyi explained the social and political upheavals that took place in England during the rise of the market economy. He noted that the rise of powerful modern states was a requirement for the establishment of a national market because only such a state could push through the revolutionary changes in social structure that accompanied the market's rise. The damage, according to Polanyi, was above all cultural as the economy was disembedded from its social base thus tearing apart the cultural bonds by which people constituted their very identity. Long-held values and inherited institutions were shattered leading to widespread cultural alienation. Relying on extensive anthropological research, Polanyi predicted that this radical disembeddedness could not last and that societies would ultimately generate counter-movements to protect themselves from disintegration. The Great Transformation that he foresaw was the inevitable pushing back of civil society against the self-regulating market and ultimately the establishment of more cooperative social economies.

[244] Max Weber, *The Protestant Ethic and the 'Spirit' of Capitalism*, (New York: Penguin Books, 2002).

Perhaps one of the reasons Polanyi has not been taken very seriously by economists and political scientists is that the great transformation he predicted never took place. Since 1944, when Polanyi's book was published, national markets continually gained in strength alongside the growth and spread of democratic institutions – Polanyi had believed that the self-regulating economy and democracy were irreconcilable and that the conflict between the two would either lead to authoritarian rule or a return to more traditional values, historical symbols and social institutions. In fact, it seems the market itself became a defining characteristic of much of Western, especially American, culture. While civil society has remained strong and has generated the establishment of numerous new institutions, those institutions have existed alongside and rarely challenged the very market systems that Polanyi thought they would be set up to oppose. With the increasing globalization of the free-market system beginning in the late twentieth century, the idea that economic relations will be restructured along social and cultural lines seems even less credible.

However, the fact that Polanyi did not accurately foretell economic and political institutional development in Western Europe does not take away from the insights he made about the revolutionary impact that occurred with the rise of national markets. Polanyi notes that part of what made the transformation so revolutionary was that it did not come about through a gradual, incremental process. However, in the Western European context that he was describing, this radical disjuncture did occur as a result of internal elite manipulations and interactions and while the process may not have been gradual, it was rooted in internal structural foundations and had internal driving mechanisms.

The establishment of national markets in the colonial context was not only sudden but was violently imposed by outsiders who were driven by external rather than internal motivations. The colonial national markets were set up to serve external interests and were built on the smashed remains of local, internally-driven economic and cultural institutions. The political and economic institutional frameworks that the colonial powers established further resulted in the rise of new internal elites who assumed new-found powers and prestige while stripping former elites of the institutional frameworks that had formerly sustained them. Polanyi's insights about the cultural alienation that occurs within society as a result of the establishment of national markets are thus much more relevant in the colonial context than they ever were in the Western European context and understanding the impact of that cultural alienation can help explain much of the political and economic trajectories of formerly colonized societies.

As Henry and Springborg point out nothing defines the Middle East better than its tradition of external intervention.[245] Because the Middle East was closer to the European heartland and it held greater stakes for the colonizers, it was competed over more intently and for a longer period of time than most other colonies. The distinctive experience of being ensnarled for nearly two centuries in great power politics left an enduring legacy on the kinds of political and economic institutions established in the Middle East and on the

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[245] Clement Henry and Robert Springborg, *Globalization and the Politics of Development in the Middle East*, (New York: Cambridge University Press, 2010), 3-11.

cultural matrix and identity politics of the region. The competitive nature of Middle Eastern colonial history resulted in internal fragmentation and sectarianism, the impeded development of institutions of public accountability, and disunified elite structures.

Henry and Springborg explain that the most successful movements of emancipation from colonialism involve a three part dialectic in which native elites first attempt to be assimilated into the colonial structure leading to a second phase backlash by those who remain excluded and then a third phase synthesis in which nationalist elites combat alien rule by assimilating its positive elements linked to the skills and values derived from a Western education while still maintaining cultural authenticity. In most of the Middle East, this third phase was never able to be fully articulated resulting in disunified and fragmented elite structures. The nationalist elites that replaced the colonialist rulers have not been able to forge durable and culturally authentic linkages with mass constituencies and are thus often perceived more as extensions of the former colonial powers than as culturally and socially legitimate rulers.

In looking at the psychological impact of colonization, Frantz Fanon described the cultural alienation experienced by peoples whose very identity had been undermined by the institutional development of colonial structures.[246] In the Middle East this alienation remains real. The colonial powers established modern states with national markets bringing about the same kind of economic and cultural transformation that Polanyi had described for Western Europe. But in the Middle East the process was even more revolutionary and even less embedded in society. The impact was not only on economic

[246] Frantz Fanon, *The Wretched of the Earth*, (New York: Grove Press, 1961).

and political structures but also reached the psycho-affective realms of the population. Polanyi's discussion of the need for a civil society counter movement that would establish economies with social meanings may not have occurred to the extent he predicted in the West, but in the Middle East where the disjuncture was greater and externally-driven, the cultural alienation has remained and the quest for a counter movement that would more securely embed the political and economic structures of the state with the cultural and social structures of society continues to explain much of the politics of the region.

Political economists have long studied the impact colonial structures and institutions have had on the economies of colonized or peripheral societies, with dependency theorists arguing that integration into the world system can increase material poverty. While such theories have come under criticism since the 1990s, what Polanyi asserts is that cultural poverty can be as meaningful as material poverty and the societal need for cultural authenticity can have a significant impact on political realities.

Jordan can almost be seen as a controlled study of this process. The borders of the country were drawn up by colonizers in a manner that had no historical or cultural rationale and a royal family that came to wield nearly absolute power was imported from outside those borders. What had previously been a tribal Bedouin society was transformed almost overnight. A modern state with a national market and one of the most modern armies in the region was established, but the state, market, and army were all detached from the population. As the old order was smashed and a new order built on top of it, many of the newly established institutions had no intrinsic meaning or value for the majority of the population. A modern banking system anchored with one of the largest and most professional banks in the region was established yet the bank and financial system as a whole excluded huge portions of the population who continued to see meaning in the religious values and principles rooted in the social and cultural institutions that had just been trampled upon.

The study of Islamic Banking in Jordan highlights the importance of cultural authenticity and represents an important example of the kind of civil society counter-movement that Polanyi asserted would occur where the disjuncture between the economy and society had become so pronounced as to tear apart the cultural bonds by which people constituted their identity. Before the onset of colonialism, the social and cultural structure of the society in what came to be known as Jordan was largely defined within an institutional framework dictated by Islamic ethos, mores and values. Even after the establishment of the modern state of Jordan, the colonizers and the internal elite that was installed to replace them attempted to maintain some semblance of continuity with that previous cultural and social value system by importing a royal family with impeccable Islamic legitimacy, incorporating Islamic terminology into the constitution and maintaining Islamic law family courts to ensure that the social and cultural institutions that had the most immediate impact on the people's livelihoods were maintained.

The ruling elite maintained a façade of adherence to pre-existing social and cultural norms through these institutions. While Islamic scholars and activists assert that Islam is a comprehensive religion covering all aspects of the state and society, Islamic law is not specific on most issues of state rule and as long as the state allowed for the continuity of some of the most basic social and cultural institutions on the level of the family and did not directly contradict a specific Islamic injunction, they could actually use Islam as a legitimating institution in the context of their rule.

However, in Jordan as elsewhere in the region, the clearest and most specific transgression against Islamic law that took place in the colonial and post-colonial era was in the area of finance. Larger issues such as the institution of the Caliphate and Islamic unity were theoretical in nature, far removed from the people's daily lives, and had already undergone much internal erosion, but finance was an area that dealt with both individuals and the state and the state could not hide the fact that it was dealing with international financial institutions and was promoting within society – either directly or indirectly - financial practices and institutions that a significant portion of the population believed were directly contradictory to their religious values.

In a 2006 University of Michigan led barometric survey of people in 7 different Arab countries, 77.6% of the Jordanians surveyed either agreed or strongly agreed with the statement that: "Banks in Muslim countries must be forbidden from charging even modest interest on loans because this is forbidden by Islam."[247] Of the 42 questions on the survey that were asked in the same format (which allowed the respondent to reply to a statement by stating that they either strongly agree, agree, disagree, strongly disagree, can't choose, or decline to answer), only 4 questions obtained higher levels of support – 3 of which dealt with gender issues and one supporting *shari'a*. Of those surveyed, 79.9%

[247] The data on the Arab Barometric Survey is online at a University of Michigan sponsored site: http://www.arabbarometer.org/reports/countryreports/comparisonresutls06.html

agreed or strongly agreed that: “A married woman can work outside the home if she wishes,” 78.9% agreed or strongly agreed with the statement that: “On the whole, men make better political leaders than women do,” and 77.8% agreed with the statement that: “Men and women should receive equal wages and salaries.”

On the *shari'a* question, 79.8% of the Jordanians surveyed either agreed or strongly agreed with the statement that: “The government should implement only the laws of the *shari'a*.” Of all the questions on the survey, the statement that even modest amounts of interest must be forbidden in Muslim countries had the highest percentage of people stating that they strongly agree – 45.9%. Another question on the survey asked respondents if they identified themselves primarily as a Jordanian, a Muslim, an Arab, a Christian, or other and 63% replied that their primary identity was that of a Muslim. The survey underscores the deep seated resistance to conventional financial practices among the majority of the Jordanian population, a population which identifies itself much more with Islam than with any ethnic or national identity and which also overwhelmingly supports the implementation of *shari'a* in the country.

The alienation resulting from the imposition of an alien financial system upon the population contributed to the problems of political illegitimacy, societal fragmentation, and economic stagnation in Jordan as well as other regional states. The backlash that Polanyi would have predicted has occurred with the rise of Islamist movements that call for a return to an idealized vision of an Islamic society – a society in which political, societal, and economic institutions are all linked to authentic Islamic institutions and practices. The Islamists have put forth a culturally authentic vision of society that is however often removed from the political, financial, and economic realities of the modern era. Henry and Springborg posit that the rise of Islamic Banking can conclude the third part of a dialectic synthesizing global financial systems and realities with culturally authentic financial practices. In doing so, Islamic banking can both help bring closure to the still lingering political and societal alienation brought about by the lack of full independence from colonial strictures as well as help integrate a country like Jordan into the world economy in a manner that remains culturally authentic.

Islamic banking was introduced to Jordan in 1979. Compared to other more established banks in Jordan, the Jordan Islamic Bank has been relatively inefficient, has proven incapable of providing the same level of banking services as its competitors, and has generally provided less of a return on deposits while charging higher rates for loans that conventional banks (see Chapter 4). Yet despite these shortcomings, the bank has enjoyed a phenomenal growth rate – even though for most of its history it did not even have a marketing department. JIB has become one of the largest banks in Jordan and while Islamic banking attracts less than 10% of Jordan's overall deposits in terms of capital, the number of deposits – at over 700,000 – is huge for a country of less than 6 million people of whom 37% are under the age of 15. The fact that the JIB – despite its lackluster performance and its lack of marketing - has been able to attract approximately 1 deposit for every 4 Jordanians over 15 years old underscores the widespread demand for Islamic finance in the country – a demand that proves the importance of cultural authenticity in societal institution building.

This phenomenal growth rate is despite the indirect hindrances imposed on the growth of Islamic finance that have been created by the state's fear of political Islamists, the natural allies of financial Islamists. Political Islamism has had an interesting history in Jordan. During the heyday of Arab Nationalism in the 1950s and 1960s when Gamal Abdul Nasser of Egypt enjoyed widespread popularity throughout the Arab world and threatened the stability of the moderate, pro-Western regimes in the region, the Jordanian Monarchy forged close ties to the Muslim Brotherhood, the largest pan-Islamic movement in the region. The Brotherhood provided the monarchy with a culturally legitimate counterweight to the calls for Arab nationalism and socialism which were resonating with many of the educated youth in the Arab world and which led to revolutions in Egypt, Syria, Iraq, Libya and Yemen. King Hussein's alliance with the Brotherhood was an important factor in saving the Jordanian Monarchy from being overthrown during a period of intense political upheaval which led to an attempted coup in 1957 and then again during a civil war pitting the monarchy against Palestinian movements based in the country in 1970.

The alliance between the Jordanian Monarchy and the Muslim Brotherhood was predicated upon their mutual opposition to the secular, leftist, nationalist movements sweeping the region at the time. While Egypt and Syria were engaged in an often competitive struggle to lead the Arab socialist movement, they both were active in supporting opposition to the Jordanian Monarchy while also severely repressing their Muslim Brotherhood chapters internally. Brotherhood members from both countries often found refuge in Jordan. The Jordanian Monarchy needed the Brotherhood to shore up its grassroots base of support at a time when the real threat to the regime was from leftist, nationalist elements. The Brotherhood also found in the Monarchy an ally that could provide a haven against the repression they were suffering from elsewhere. This alliance of mutual convenience was more a surface than a principled alliance. The Jordanian Monarchy and the Brotherhood could benefit from each other's support while maintaining different worldviews and seeking different objectives.

Jordan's close ties – even political and economic dependence - to Britain and later the United States rankled the Islamists who sought security and economic development through the establishment of a true "Islamic State" and a vision of pan-Islamic unity rather than ties to the West. While indebted to the Islamists for providing crucial grassroots support at critical junctures, the Jordanian Monarchy remained wary of the Islamists themselves and always kept them at some distance from real political power while also keeping them under close observation and not shying away from using light forms of repression against them as a means of keeping them in check. Jordan remained the only country in the region in which the Brotherhood could maintain a legal status and the Brotherhood leadership understood and accepted the limitations placed upon them by the Monarchy in return for the benefits that accrued from this legal standing.

The limited freedom in a context in which both the Monarchy and the Islamists understood that the Islamists would never partake of real political power led to a situation in which the Islamists were free to vocally express a utopian vision of an Islamic state and Islamic economy without ever having to face the responsibilities of true economic and political decision-making. When the Nasserist and Ba'athist secular Arab nationalist experiments throughout the region proved unable to bring about the kind of political and economic development and progress that they promised, the popularity of such movements declined and the Islamists largely filled the void on the grassroots level and among the educated youth. The Islamists became the only real grassroots threat to the stability of the Jordanian as well as the other regimes in the region.

With the decline of the leftist movements and the rise in Islamic sentiments throughout the region, it became even more important for the Jordanian Monarchy to use Islamic symbols as a way of legitimating its rule. Permitting the establishment of Islamic banking in the country was certainly one element in this process of popular legitimation. Even by the late 1970s when Islamic banking got its start in Jordan, the political Islamists had already replaced leftist nationalists as the most threatening political force in the country.

While Islamists played a key role in the formation and development of the ideas and institutions of Islamic Banking in Jordan (see Chapter 5), they themselves recognized that the success of the enterprise depended in large part on it remaining apolitical. Finance is power and for an opposition movement to openly control a major financial institution could be interpreted as a quest for political power when the political Islamists were less interested in using banking as a means of increasing their political strength against the monarchy than in proving that Islamic economic and financial theories could work in the modern era and in providing Muslims in the country with an Islamically valid manner of conducting simple financial transactions. The state and the Brotherhood leadership had an unspoken understanding of the extent to which political Islamists would be tolerated within the financial Islamic sector and the Brotherhood never crossed the lines of what would be seen as acceptable.

By preventing the establishment of a natural alliance between political and financial Islamists, Jordan has however lost the opportunity to use Islamic finance as a means of strengthening societal institutions and civil society in ways that Henry and Springborg argue would promote the kind of political and economic development that would best equip Jordan with the tools to succeed in the era of globalization.

As long as Islamists continue to form the most cogent political force in the country yet remain removed from any level of decision-making responsibility, the country's fragmented and disunified political elite structure will impede opportunities for political and economic growth. A 2003 Pew Global Attitudes Project that looked in detail on how peoples in different parts of the world viewed globalization found that people in the Middle East had by far the most negative views of globalization and international organizations and among the most negative views of multinational corporations in the world.[248] Noland and Pack argue that these popular attitudes form one of the greatest obstacles to economic reform in the region.

Such attitudes can be traced largely to the region's colonial experiences during which foreign companies and organizations exploited the region and supported policies that impeded economic growth. However the region's colonial experiences cannot fully explain the prevalence of such attitudes in the Middle East as opposed to Africa or Latin

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[248] For an analysis of the Pew Global Attitudes Project see Marcus Noland and Howard Pack, *The Arab Economies in a Changing World* (Washington D.C.: Peterson Institute for International Economics, 2007), 187-207.

America, where the colonial experiences were even more exploitative. Such attitudes are more attributable to the manner by which the Middle East's colonial experiences resulted in an elite structure in which the most popular societal leaders can make populist anti-globalization diatribes yet have no responsibility for economic and political decision-making.

Bringing the colonial experience to a closure through the three part dialectic described by Henry and Springborg does not guarantee democratization or economic growth; it however does help bring about an elite structure and elite-mass relations that make such political and economic development more likely. The fact that most countries of the Middle East did not complete this dialectic process has resulted in a disunified elite structure and a near constant quest for legitimacy by the ruling elites of the region – a quest which distracts them from pursuing policies needed for economic and political development.

Henry and Springborg argue that Islamic finance offers states in the region the opportunity to go through a belated dialectic in which the Islamist opposition is brought into the already existing alliance between *shari'a* scholars, government officials, and Islamic bankers. Bringing political Islamists into the alliance would strengthen the Islamic banking sector while providing political Islamists with the opportunity to play a more responsible economic decision-making role. To allow for this natural alliance to take place would end the dichotomy between a modernizing elite around the monarchy and a culturally centered Islamist elite that is seen as authentic and garners widespread popular support though has little real political power. This disunified elite structure has resulted in a situation in which the monarchy, while theoretically pro-business and supportive of globalization, is hindered from fully articulating these views because the lack of a national consensus forces it to rely on business-inhibiting patronage networks for support and legitimacy while not allowing the country to break its dependence on economic rents to keep the country afloat.

From a political perspective, Jordan would be an ideal country to allow this dialectic to play out. The Islamists in the country have strong grassroots support and yet have always recognized that it is within their interest to shore up the monarchy rather than seek its overthrow. While the divide between Palestinians and East Bank Jordanians has constituted the most explosive and potentially destabilizing factor in the country, the Islamists have been the only movement in the country able to cross the divide and bring about a semblance of unity and shared interests. The Islamists have advocated a populist economic and foreign-policy agenda that often conflicts with the policies pursued by the monarchy but keeping them at arm's length from real power has provided them the luxury of being able to continue calling for such policies without having to account for the impact such policies would actually have on the country.

While an agreement between the Monarchy and the Islamists on contentious and divisive foreign policy issues seems unlikely at the present time, allowing Islamists into an alliance that ultimately gives them a stake in the economic development of the country and allows them to play an economic decision-making role could provide the opening that results in closing the gaps and bringing about a more unified elite structure in the country. Political Islamists have already played a central role in the development and progress of Islamic banking in Jordan. Establishing an environment in which that role is allowed to take its natural course would force the Islamists to go a step beyond discussing a theoretical vision and toward articulating that vision in ways that would likely be very similar to the vision espoused by the pro-globalization elements of the ruling elite, thus helping establish a national consensus in the country.

Islamic finance is well-suited to the role of being a conduit for the integration of political Islamists into the ruling elite not only because it provides an arena of policy-making that is removed from the more contentious security and foreign policy arenas but also because the theoretical foundations of Islamic finance are even more in tune with the demands of globalization than are traditional banking methods and theories. Islamic finance cannot work properly unless there is a regulatory framework in place that allows for transparency and accountability. Whereas conventional banks work on fixed interest rates, Islamic banks work on profit-sharing formulas that require firms to accurately calculate and report their profits and losses.

Conventional banks - especially in systems in which banking provides the predominant form of credit - can establish strong ties to business elites within a country without a concomitant need for an overall environment of transparency, accountability and regulatory authority. Equity rather than credit-based financial systems that follow the Anglo-American model of providing capital through financial markets and have strong stock exchanges require a much greater level of transparency to be successful. In the era of globalization in which the attraction of foreign capital through financial markets is a key to the success of emerging economies those with Anglo-American systems have certain advantages. The equity-like financing model of Islamic banks have the same kinds of regulatory and transparency needs that Anglo-American financial systems have and can only reach their full potential in environments in which such systems are embedded.

Thus not only will an alliance between Islamic banks and Islamist political movements give the Islamist opposition a stake in the economic success of a country but will also provide them with an incentive structure leading them to advocate the kinds of policies that are needed for a country like Jordan to move away from a patronage based business-state framework (which is dependent for its success on the continuation of rents - in the form of foreign aid and remittances) and toward a business-state framework and elite structure that is more in tune with the demands of globalization. With Samuel Huntington's theory of the Clash of Civilizations and the post 9-11 media hype about the incompatibility of Islam with the West and the supposed dangers inherent with the spread of *shari'a* law in the West, it may be counterintuitive to find that within economics and finance, the spread of *shari'a* – and an alliance that forces Islamists to root their policy proposals on actual *shari'a* sources rather than irresponsible populism - may move Islamist movements toward a more accommodationist stance vis-à-vis the West, at least in the realm of economics and global capital flows.

Shari'a-compliant banking has become a buzzword that is well-known and respected in the corridors of international financial institutions. The World Bank has concluded numerous studies on the phenomenon and Islamic banking is well-covered in the world's top economic journals and newspapers. Harvard University has dedicated a center to the study of Islamic Finance and holds annual Islamic Banking conferences while European countries are now competing to become the Western world's hub for the Islamic finance industry – with London clearly in the lead, having established numerous Islamic banks in the city while nearly all the large corporate law firms in the country have large Islamic Finance groups and the British Government has worked assiduously to bring about a legislative framework that accommodates the needs of Islamic banking.[249]

Pete Moore has rightly argued that political context best explains the problems with Jordan's business climate.[250] Business-state relations are embedded within a larger political context and just as patronage networks establish distortions in the functioning of an economy in its most efficient manner, the politically inspired break up of what would be a natural political and economic alliance establishes distortions in the most efficient political and economic functioning of a polity. In the case of Jordan, these distortions are best represented by the rapid growth of Islamic banking in a way that can only be explained by a clear societal based quest for what Polanyi would describe as cultural and institutional authenticity and the simultaneous politically-inspired constraint on permitting those banks to be linked to the popular Islamist movement. These distortions have intensified the fragmentation of the country's elite structure thus impeding Jordanian political and economic development.

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[249] David Oakley, "The Future of Islamic Finance: London Leads in Race to be Western Hub", from *Financial Times Special Report: The Future of Islamic Finance*, Dec. 8, 2009, p. 4.

[250] Pete Moore, *Doing Business in the Middle East: Politics and Economic Crisis in Jordan and Kuwait*, (Cambridge University Press, Cambridge, 2004).

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